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ECONOMIC RECOVERY AND MONETARY STABILIZATION

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
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EDITED BY
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PREFACE

MONEY is a topic of perennial interest, practical and theoretic, but it has assumed more than ordinary significance in the economic crisis, the recovery program, and present calculations of what the future may hold in store. In much of the current debate on this controversial subject, partisan politics, prejudiced propaganda and a popular penchant for panaceas are all too prevalent. This issue of the PROCEEDINGS is intended not to add to the heat of the argument, but to focus a series of informed opinions and factual statements, by leading economists and financiers, on such questions as whether currency should be stabilized on a gold basis or freely managed, whether stabilization should be national or international, whether credit can be controlled, whether inflation lies ahead, whether the fiscal program of the government is directed toward prosperity or toward disaster.

These papers were presented at the Semi-Annual Meeting (Fifty-sixth Year) of the Academy of Political Science. The three sessions, held at the Hotel Astor in New York City on April 2, 1936, were attended by exceptionally large and representative audiences. It is appropriate to express the Academy's gratitude to the speakers and to thank the Committee on Program and Arrangements, the membership of which is here recorded: Leon Fraser (Chairman), Ethel Warner (Director), W. Randolph Burgess, S. Parker Gilbert, Thomas W. Lamont, George O. May, Ogden L. Mills, Wesley C. Mitchell, Shepard Morgan, William L. Ransom.

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PART I

CREDIT CONTROL AND THE RECOVERY PROGRAM—DOMESTIC ASPECTS

INTRODUCTION *

WINTHROP W. ALDRICH, *Presiding*
Chairman of the Board, Chase National Bank, New York

THIS is the first session of the semi-annual meeting of the Academy of Political Science. With today's sessions the Academy is approaching the close of its 56th year of honorable life. When it was organized in 1880, the purpose its founders had in mind was the creation of a forum where political and economic problems in the life of the nation could be discussed freely and openly for the benefit of a public desiring additions to knowledge and stimulations to thought. The views expressed by each speaker are his own views and are not necessarily the views of the majority of the members of the Academy. Frequently it develops that the words of one speaker do not conform with the words of another. Perhaps this freedom of discussion and diversity of opinion are the great merits of the Academy programs. Variation of opinion, granted a necessary quality of substance, provides the material out of which the public at large can frame its own conclusions.

The topic arranged for today's meeting is "Economic Recovery and Monetary Stabilization". At the session this morning we are to deal with the domestic aspects of this subject as expressed in the topic "Credit Control and the Recovery

* Introductory remarks of Mr. Winthrop W. Aldrich as presiding officer, opening the first session of the Semi-Annual Meeting (Fifty-sixth Year) of the Academy of Political Science. In order to meet the exigencies of the radio broadcasting schedule, Mr. Aldrich's principal address was broadcasted not at the beginning, but at a later stage in the program, *cf. infra*, pp. 26-29.—ED.

Program ". At the afternoon session the meeting will consider the general subject again, but in its international aspects. And this evening the question will be further examined at the dinner session of the Academy. I am asked particularly to state to you at this point that dinner will be served promptly at seven o'clock. We must observe the hour with strict punctuality because a part of the evening program will be broadcasted, and as you know, a radio audience insists on absolute adherence to schedule.

This morning parts of our program also will be broadcasted and if I exercise my duty as chairman rather rigorously I hope you, and especially the speakers whom I may have to interrupt, will understand that I am merely fulfilling obligations with respect to a prearranged and inflexible schedule.

I hope the gentlemen who are to speak to us will carry out the Academy tradition of not agreeing too closely with each other. Each is an authority in his own field, and as such each is bound to have definite, and I trust, individual opinions. I do not promise even for my own part to agree with all of them. It would be too much to expect, furthermore, that all of them would agree in all things with me. It is through healthy diversity of view that we shall hope to gain the full advantage that the Academy sessions offer.

The first speaker whom it is my pleasure to introduce this morning is the director of Research and Statistics of the Federal Reserve Board in Washington. He has been in the service of the Board since 1919, is intimately familiar with its powers and duties, and more than that, he is the close observer week to week and month to month of the statistical raw material which the Federal Reserve Board must scrutinize and from which it must draw conclusions when it undertakes to put positive policies into effect. The subject he will discuss is " How Can Credit Be Controlled? ".

I take pleasure in introducing to you Mr. E. A. Goldenweiser.

HOW CAN CREDIT BE CONTROLLED?

EMANUEL A. GOLDENWEISER
Director of Research and Statistics
Board of Governors of the Federal Reserve System

THE subject of this paper is "How Can Credit Be Controlled?". If one were to consult past experience, it would seem that machinery for controlling credit successfully has not yet been developed. Prior to the establishment of the Federal Reserve System there was no machinery in this country for credit control and whatever control there was, was of an automatic nature.

Since the establishment of the Federal Reserve System, we have had an enormous credit expansion during the war period, a very rapid contraction in 1920-21, with some disastrous results, a rapid increase in credit from 1922 to 1929, a collapse in 1929 that continued until 1933, a rapid expansion since 1933. It certainly is not a record that would indicate successful credit control. If we are to prevent the recurrence of such violent alternations in the expansion and contraction of credit as we have lived through in the twenty-two years since the establishment of the Federal Reserve System, the problem of credit control must be reëxamined.

There are those who believe that credit control should be essentially qualitative; that the most important thing about credit is its quality, and that if its quality is all right, the country will be safe. There are those, on the other hand, who lay their principal emphasis on the quantity of credit, either from the point of view of bank assets or from the point of view of deposit liabilities which are referred to as money.

The conclusion to which I have come, in thinking about this subject, is that a perfect, an ideal control of credit would be the same whether it controlled the quantity or the quality, because a complete quantitative control would result in satisfactory quality and complete qualitative control would result in satisfactory quantity. If no bank extended credit that was not of perfect quality from the community's as well as from the individual bank's point of view, the aggregate quantity of credit would also be in the best interests of the economy. On the

other hand, if quantity were rigidly controlled and adapted to conditions that existed at all times, it is likely that there would be no great departure from adequate quality, because it is during periods of very rapid expansion or contraction that the quality of credit greatly deteriorates. I think, therefore, that this controversy is, like so many others, merely a matter of emphasis. From the point of view of responsible administration, both phases have to be considered, and considered in the light of the possibilities of regulation that are practically attainable.

There are great limitations on complete control of quality. In the first place, we have a banking system under which banks are chartered by forty-nine authorities without coördination. We have supervisory authorities scattered over the country, working under national laws and forty-eight state laws, and under different rules and regulations in relation to bank supervision. Under such circumstances thorough qualitative control is impossible or at least extremely difficult.

There are other limitations on the effectiveness of supervision. The best supervision involves one or two examinations a year, but many things can happen between examinations. Besides, there is the fundamental point that, even though the quality of the credit in an individual bank, from the point of view of its own solvency and efficiency, were perfect, there might easily be an aggregate situation that was not perfect at all. We all know, to use a very well known illustration, that brokers' loans were perfectly good loans and that no losses were suffered from brokers' loans by any bank, and yet the aggregate of brokers' loans during the period of greatest expansion was one of the things that did threaten the economy of the nation.

The multiplicity of banks conducted by individual managements makes the problem of supervision an extremely difficult one. Control of quality is much easier in countries where the number of banks is smaller and management is centralized.

There is, in addition to all of these considerations and others that I could enumerate, the great difficulty that the quality of credit depends on economic health and soundness. With bank credit serving as the basis of the principal means of payment that we have, the banking situation cannot remain sound if the economic situation is not sound. There is a mutual interrela-

tionship. Perfectly sound loans and investments, made at a time when the national income is eighty or ninety billions of dollars and the price level is relatively high, become entirely unsound and disastrous when the national income is cut in two and the price level has precipitately dropped.

It is, therefore, not feasible, with existing machinery and in the present state of human knowledge, to control quality completely. All that can be done is to exercise an influence in the direction of sound quality. I might say parenthetically that it is for this reason that I dislike the word "control". If I were wording the title of my remarks, I would not use the word "control". I would use the much more modest term "influence".

There are limitations also on the control of the quantity of credit. First I might mention the fact that monetary powers are not concentrated in the Federal Reserve System. In the present situation, the powers of the Treasury in connection with handling the stabilization fund, its power and duty under the law to purchase silver, its power under the Thomas Amendment to issue paper money, and the control of very large funds which the Treasury can move in and out of the market, are powers that are monetary in their nature. Therefore, it is evident that the monetary authority does not possess complete monetary powers.

But, assuming that the two agencies work hand in hand, as of course they do, there are other limitations on the control of quantity. There is an imperfect control of the volume of deposits because it is not possible for monetary authorities to make the borrowers borrow or to compel the banks to lend or to invest when the situation is not propitious.

Since the beginning of the depression, the powers of the Federal Reserve System and of the Treasury have been exercised in the direction of continued monetary ease, the building up of member bank reserves to an unprecedented volume. The result has been a growth of deposits; but those deposits, even though now larger in quantity as far as demand deposits are concerned than ever before in history, have not been utilized to the extent that they would have to be in order to finance full productivity in this country. So we have a limitation on quantity control, if in the concept of quantity you include the use or velocity of money.

There are also limitations on the opposite side. When credit is wanted and used it has not yet been found possible to control its expansion completely, because drastic measures usually involve too heavy repercussions. The responsibility for drastic control of expansion has never yet been undertaken. Still I think that the control of expansion is more feasible than the control of contraction, and that the only safeguard against future depressions is in the prevention of inflation.

Aside from the regular fiscal functions of the Treasury, the powers which are inherent in the necessities of the Treasury situation have an important monetary aspect and one that is not fully recognized by many, because the problems of whether the government is going to borrow and spend, and how much, and at what time, and whether it is going to borrow from the banks or borrow from the public, all have distinct monetary phases that are quite independent of the general problems of fiscal policy.

What I am trying to say is that complete quantitative control of credit would involve a system of complete control of the volume and flow of the national income, of its distribution between consumption channels and productive channels. It would involve a system of taxation, of Treasury financing, of central banking control, that is far beyond any control that we have as yet ever visualized or that we are prepared to adopt.

For that reason, on the quantitative side as well as on the qualitative, the only thing that can be done is to influence the forces, to exercise the instruments of credit management that we have, in their relation to the many forces that are beyond our control.

In connection with what I have said, the question arises, what becomes of the concept of independence of a central bank from the government. If the Treasury policies, not only temporary monetary policies but fiscal policies, have such an important monetary bearing, can and should a central bank be independent of the Treasury?

After the war we had meetings in Brussels and in Genoa at which it was loudly proclaimed that the most important thing for a central bank is to be independent of the government. Those feelings reflected reaction against the terrible inflationary conditions through which the European countries had gone after the war. On final analysis, they were an outcry against

war rather than an outcry against government control of the central banks, because when there is a war, all national issues are submerged in the one necessity of winning the war. No war has ever been fought on taxation alone, and it is difficult to imagine that one ever would be, because taxation of the degree and quantity required to finance a war is not politically possible. Therefore, war invariably involves inflation; and during such a period the monetary systems of the world are disrupted. Whether they are disrupted, as they were in most countries, by the issuance of currency through a central bank and borrowing of the government from the central bank, or whether they are disrupted, as they have been in other countries, by the printing of money directly by the government, is in the final analysis not a matter of vital importance. Of the two, probably the central bank plan is a better one because it has better terminal facilities.

It does not seem feasible or practical for a central banking authority to function independently of the Treasury. It never has been independent anywhere, nor do I think it ever will be. What is meant by "independent" in a realistic sense? The Treasury has its principal function in the raising of revenue and distribution of it for purposes of meeting the expenses of the government. The central bank has monetary objectives. Between the two authorities there must be a close coöperation, a mutual understanding and mutual respect, a mutual influence. The two financial authorities must not be in conflict with each other. An independent central bank, in a realistic sense, means a central bank with so much courage and competence that it cannot possibly be ignored by the Treasury, first of all because the Treasury will wish to have the benefit of the central bank's judgment, and in the second place, because the public respect for the central bank in authority would be such that the Treasury could not ignore it.

That is the kind of situation toward which we have to work. That is really what an "independent" central bank means. That is the situation which prevails in England. The fact is not that the Bank of England is entirely separate from the Treasury. They coöperate, work together every day, but it is true that the prestige of the Bank of England and the competence of the bank are such that the Treasury would not disregard the Bank's advice.

Having reduced the subject of credit control to the question of the influences that can be exercised, I would like to say just a few words on what the objectives of that influence should be. We have had a great deal of discussion about the objectives.

There has been a long-standing agitation in favor of using all credit powers in the direction of a stabilized price level. I cannot take the time to discuss the weaknesses of that objective, but it is perfectly clear that stable prices, especially stable aggregate prices, are not always consistent with the best interests of the country, and have been accompanied at times by serious economic maladjustment.

I am inclined to think that even business stability—which is a vague term describing the goal toward which in a general way one should try to work—is not necessarily desirable. Stability has an implication of stagnation. A growing economy is not a stable economy. Every minute is a crisis and every period is a transition.

We have tried to formulate the objective of monetary policy in a general way as a policy that would result in the fullest utilization at all times of the human and natural resources of the nation. If the central bank authorities were capable of contributing consistently to the pursuit of that objective, I believe they would come as near to using their influence in the public welfare as is possible.

I have pointed out many of the limitations on the powers of the central bank. In a brief period I can say very little more on the subject. I want to add, however, that what I say is not intended as a plea of impotence or a counsel of despair. In steering a ship through the gale, one is not weakened by recognizing that one cannot control the waves and the winds and the storms and the tides. One should use such powers, such knowledge as is derived from the charts, such power as is lodged in the engines, and such direction as the rudder can give, to steer the ship safely to port in defiance of all hostile elements of nature.

I feel that a full realization of the limitations on what can be done, and of the forces which the policy must take into account and which, in many cases, it must overcome, will contribute more toward a realistic use of monetary powers than a belief in complete control without appreciation of the limitations that will remain in the way of such control as long as our general plan of economic and political life persists.

Remarks by the Chairman

Mr. Winthrop W. Aldrich: I am sure that you will all agree with me that we have just listened to an extraordinarily interesting and authoritative discussion of the limitations upon the power of the central bank to control credit.

I find myself in entire agreement with what Dr. Goldenweiser has said, and it might be appropriate to say that in my view the qualitative control of credit is primarily the function of the commercial bank, the quantitative control being centralized in a central bank. The commercial banker, in attempting to exercise his judgment as to qualitative credit at any given moment, is very often influenced by a situation which exists because of the fact that the quantity of credit is too great. I am going to say a word about that later on.

I now have the pleasure of introducing to you a speaker whom many of you know already. A friend of the Academy and a teacher of economics at Columbia University, he has generously agreed at almost the last moment to take the place on our program originally set aside for Professor Neil Carothers, Professor of Economics at Lehigh University. The speaker this morning has written books with which you no doubt are familiar. They are vivid contributions to the thought of our time. The topic on which he speaks is " Fiscal Policy and Credit Control ".

I am glad to introduce Mr. Ralph Robey.

FISCAL POLICY AND CREDIT CONTROL

RALPH ROBEY
Instructor in Banking, Columbia University

THE problem of fiscal policy and credit control has, it seems to me, two aspects that are more or less distinct. The first of these is the question of the relation of fiscal policy to the necessity of credit control. The second is the relation of fiscal policy to the possibilities of credit control. In the time allotted to me I should like to attempt to analyze both of these aspects, not as theoretical problems, but rather in terms of the situation as it exists in this country today.

I turn first to the question of the relation of the fiscal policy of the present Administration to the necessity of credit control. The points at issue here, as I see it, are whether the fiscal policy followed in this country during the past few years has been, in and of itself, inflationary in character, and whether the policy has been conducive to inflation in other parts of our economic system. Before we can discuss these issues with clarity, however, it is necessary to get working definitions for the terms " inflation " and " fiscal policy ". This does not mean that we need to be in agreement on the meaning of these terms. Rather, all that is necessary is that we understand the sense in which the terms are used.

Perhaps it will be sufficient for the purpose at hand, therefore, for me to say merely that when I use the term "inflation" I shall mean fiat purchasing power—that is, purchasing power which at the time of its creation has no counterpart in the form of economic goods. I am making a distinction, in other words, between the purchasing power brought into existence by the government issuing greenbacks, or by the banks merely writing up pen-and-ink credits, and purchasing power resulting from the production of economic goods.

In the term " fiscal policy " I shall include all of the financial activities of the government. That is, I shall think of it not only as the handling of the receipts, the expenditures, the debt,

and the deficit of the government, but also as including its monetary policy. This is, perhaps, a somewhat broader meaning than frequently is assigned to the term "fiscal policy", but during the last few years the monetary policy of the Administration has been so intimately related to the handling of the public debt that it seems to me that it is not feasible to consider the one without the other.

If you are willing to accept these definitions as adequate for the purpose of analysis, we can rephrase, in more meaningful language, the question of whether the fiscal policy of recent years, in and of itself, has been inflationary. We can restate this problem as, whether the monetary policy and the deficit financing of the last few years have resulted in the creation of fiat purchasing power. When put in this way, it seems to me, we have our issue in a form which is susceptible of statistical proof. To get this proof we need merely to look to our banking and financial statistics.

The record of these statistics is clear and unmistakable. It shows conclusively that our recent fiscal policy has resulted in the creation of fiat purchasing power. Such fiat purchasing power has come, it is true, not through the government printing greenbacks—although it has printed something just as bad, if not worse, in connection with the silver policy—but through our banks writing up pen-and-ink credits on their books in payment for United States government obligations. The amount of such creation of fiat purchasing power has been enormous. This is shown by the increase of bank deposits. Some figures on this are worth recalling.

Between November 1, 1933, and October 30, 1935—the last date previous to the new classification of deposits—the net demand deposits of the weekly reporting banks increased approximately $6,000,000,000. Such reporting member banks compose roughly 50 per cent of the banking resources of the country. Accordingly, if we assume that there was the same rate of increase in the rest of the banking system, we find that during this two-year period net demand deposits increased by about $12,000,000,000, or at an average weekly rate of some $115,000,000.

To appreciate the significance of these figures it is necessary only to refer to the comparable statistics for the last two pre-

ceding periods of inflation. From June 30, 1916, to June 30, 1920, the increase of demand deposits for the banking system as a whole was approximately $4,000,000,000, or some $19,-000,000 a week. (This does not include "unclassified" deposits.) From June 3, 1921, to June 30, 1929, the increase of demand deposits in all banks was approximately $8,000,-000,000, or again at the average rate of about $19,000,000 a week. During the first of these earlier inflationary periods, you will remember, the wholesale commodity price level of the United States more than doubled, and during the second, industrial stock prices more than quintupled.

As measured by the volume of purchasing power in the form of demand deposits in our banks, therefore, we recently have been inflating at an average weekly rate some six times as great as we did in the commodity price inflation of 1914-1920 and in the stock price inflation of 1921-1929.

It is not to be concluded from this comparison, of course, that all this increase of deposits in our banks has been the result of banks writing up pen-and-ink credits in payment for government obligations. That has been a large factor, but it has not been the sole factor. Neither has it been the sole means by which the fiscal policy of recent years has resulted in the creation of fiat purchasing power. For fiat purchasing power also has been created through our monetary policy, as it has related to both gold and silver.

The creation of the fiat purchasing power here has been by means of placing a new and arbitrary value upon the precious metals, and then using this new value as a basis for currency issue. In the case of gold the increase, as you know, was from $20.67 to $35.00 an ounce. This change involved a writing-up of the value of the gold held by the government by approximately $2,800,000,000. But this is only part of the fiat purchasing power resulting from our gold policy. Since the revaluation took place we have imported some $3,000,000,000 of gold. This is at its new value. Before revaluation the same quantity of gold would have been worth only about 1¾ billion dollars, instead of the 3 billions at which it now is carried on our books. There has been a further write-up here, then, of 1¼ billion dollars, or a total write-up as the result of revaluation of some 4½ billion dollars.

Not all of this write-up has been injected into the economic system. For example scarcely any of the original so-called gold profit has been used. On the other hand, all of the write-up on the gold that has flowed to this country since revaluation is in the economic system. Not only is it in the economic system, but it is in the system in perhaps the most dangerous way, for most of it is to be found in the reserves of our banks. In other words, the reserves of our banks today are some 1¼ billion dollars greater than they otherwise would be, even granting there would have been just as much gold imported without revaluation, and needless to say there would not have been.

As for our silver policy, from the point of view of the creation of fiat purchasing power, I have little to say. What we have done, as you know, is to buy the metal in huge amounts and then write its value up to $1.29 an ounce as a basis of currency issue. As far as I can see, it would have been just as sound economically to have used discarded paving blocks. In fact, paving blocks would have had one distinct advantage. Using them as a basis of currency issue would not have subjected foreign silver-using countries to severe pressure, as our silver policy has done. In other words, our silver policy has been a straight out-and-out program of inflation.

So much for the question of whether the fiscal policy of recent years, in and of itself, has been inflationary. The next point I listed for discussion was whether the fiscal policy has led to inflation in other parts of the economic system.

This, it seems to me, does not need extended treatment. It must be evident to everyone that the recent fiscal policy of our government has tended to restrain, rather than encourage, private borrowing. It is impossible to determine what this restraint has amounted to in dollars, but for the present purpose this is not necessary. All we need at the moment is the conclusion that the creation of fiat purchasing power through loans to private individuals has not been greater, because of our fiscal policy, than it otherwise would have been. Even New Dealers, I believe, would agree with this conclusion.

Such, then, in brief, is the analysis which it seems to me is a necessary preliminary to answering the broad question of whether our fiscal policy of recent years has given rise to a

need for credit control. My answer to this question obviously is that I think it has given rise to such a need. My reason for thinking this, to repeat, is that the government, both through its handling of the deficit and through its monetary policy, has been following an inflationary course. It has been creating purchasing power for which, at the time of creation, there is no counterpart in the form of economic goods. It has been doing this, too, without setting up any automatic checks as to the amount of such fiat purchasing power that may be created. In fact, it has been doing it in a manner that makes it virtually impossible, politically, to turn back. Such a situation, I am convinced, if it is permitted to remain uncorrected, can mean only disaster for our economic system. I feel, accordingly, that it is imperative that the present inflationary policies be brought under control.

I turn next to the second broad aspect of my subject, namely, the relation of our fiscal policy to the possibilities of credit control. Here again, too, I think it advisable to subdivide the problem. Accordingly I propose first to discuss the problem on the assumption that we have a continuation of federal deficits, and then to discuss it on the assumption that we balance the budget. Actually there is no particularly compelling reason for making this distinction, for the problem is about the same under both conditions, if one is starting from the present situation, but since many people seem to think that once the budget is balanced our troubles will be over, it has seemed best to me to make the division.

First, as to the situation with an unbalanced budget: Is there a possibility of the credit-controlling authorities bringing about a tightening of interest rates when the government is constantly in the market for funds? The answer to this question depends upon the relation of the credit-controlling agency to the government. If the credit-controlling agency were in a position of complete independence one might have a tightening of interest rates even though the government were running at a deficit. If the credit-controlling agency does not have such a position of independence it must meet the wishes of the government as to when the money rate is to be tightened. And, granting the government is operating at a deficit, there is, probably, just one condition in which it would permit a tightening of the rate.

This is when the deficit is of a purely temporary character, and when the holding of the public debt is such that a tightening of money will not cause the government embarrassment, either directly or indirectly.

Now what is the actual situation in the United States today? Certainly the Board of Governors of the Federal Reserve System is not independent of the domination of the government. On the contrary it is under its complete domination. This is so much the case that I am not sure that it is not now an error to think of the Board of Governors of the Federal Reserve System as a credit-controlling agency. It would be more accurate, I believe, to think of our credit-controlling agency, granting we have one, as being the Treasury Department. That is the place our credit policies are determined today. The Board of Governors is merely a part of a mechanism to be used when convenient for putting Treasury, or Administration, policies into effect.

If we are to have a tightening of interest rates while the government is running at a deficit, then, it must be because the government itself thinks that such tightening would be wise. Is there any reason to believe that the present Administration would arrive at such a decision? There obviously is not, if a prerequisite of such a decision is, as stated earlier, that the deficit be of a purely temporary character. For if there is one point about our deficit upon which we can be sure, it is that it will not be of a temporary character if the present spending is continued, and as yet this spending has shown no signs of diminution.

On both counts, thus, it seems to me, the present fiscal policy of our government makes it impossible to anticipate the exercise of any restrictive control over our credit system. I think that this is the case, regardless of the type of control that is considered. In other words I think it is true both as to the possibility of raising the reserve requirements of our banks and as to the possibility of having the Reserve Banks mop up the excess reserves of the commercial banks by the sale of a part of their government obligations. I will grant, although I think it highly improbable, that we might have a slight increase of reserve requirements, or a sale of a few government obligations by the Reserve Banks, but I can see no

possibility of either of these control measures being carried far enough to exert any significant influence upon money rates.

The final point we have for consideration is the question of the relation of fiscal policy to the possibility of credit control when the federal budget is balanced. Under some conditions, it is evident, the existence of a balanced budget means that fiscal policy is of no importance from the point of view of credit control. But we do not find these conditions in the United States today, and we would not find them if the budget were balanced in the near future. For just having a balanced budget is not all that is necessary in order to eliminate fiscal policy as a major factor in the determination of credit control policies. In addition, the public debt must be in good shape. It must be in good shape both as to those who hold it and as to the rate of interest it bears.

On neither of these points is it possible to say that at present our public debt is in good shape. Far too much of it is held by our banks, and the rate of interest on a large portion of it—on that portion composed of Treasury bills and notes—is far out of line with what must be expected once a real private demand for funds develops in this country. Even though we were to balance the budget, therefore, there still would remain some most difficult problems from the point of view of exercising any restrictive control over our credit system.

Specifically, we still would be faced with the problem of what would happen to the government bond market, and consequently to our banks, if there were a significant tightening of the interest rate, and we still would be faced with the problem of trying to keep the budget in balance if interest rates on the short-term debt of the government sky-rocketed.

This does not mean that I think that the budget should not be balanced. Quite the contrary, I think that it is essential if we are to save our financial system. But at the same time I think that balancing the budget is only one of the steps that need to be taken.

Remarks by the Chairman

Mr. Winthrop W. Aldrich: The next speaker will discuss "The Prospect of Inflation in the United States". Many of you will remember his book written a few years ago on the process of inflation in France, and more recently his discussion of the gold reserves of the United States. It is scarcely necessary to introduce to an Academy audience James Harvey Rogers, Professor of Political Economy in Yale University.[1]

[1] *Cf. infra*, pp. 128 *et seq.* for the paper presented by Professor Rogers.—Ed.

Remarks by the Chairman

Mr. Winthrop W. Aldrich: The next subject for discussion is "The Silver Purchase Program and Its Consequences". The speaker served his apprenticeship in financial writing with the Federal Reserve Bank of New York. He then went to the National City Bank of New York where little by little he has dovetailed into the work which his father, Mr. George E. Roberts, has done with distinguished success for a generation. The names of George Roberts, father and son, are indelibly associated with the excellent monthly review of financial and economic developments which has long been published by the National City Bank. Both father and son are well known to Academy audiences, so I announce rather than introduce the next speaker, Mr. George Bassett Roberts.

THE SILVER PURCHASE PROGRAM AND ITS CONSEQUENCES

GEORGE B. ROBERTS

Vice-President, The National City Bank of New York

IT is about two years since the United States embarked on its program of doing something for silver, first, by buying up domestic production in accordance with the agreement on silver reached at the London Economic Conference, and, later, under the Silver Purchase Act of June, 1934, by nationalizing silver and extending the purchases into world markets.

The main arguments on behalf of the silver program were that it would put more money into circulation and correct an alleged shortage in the metallic reserve; also that by raising the price of silver it would increase the purchasing power of silver-using countries, while at the same time — paradoxically, it would seem—eliminating those countries as trade competitors by driving up their exchanges and making their goods more costly to buyers. It was said that our silver purchases would enable foreign countries to pay their debts and buy our agricultural surpluses, and that they would help redistribute some of our surplus gold stocks. In short, silver, according to its sponsors, appeared to be the sovereign remedy for the depression.

In passing the Silver Purchase Act, Congress intended to raise and stabilize the price of silver, broaden the monetary base, and encourage a wider use of silver as money among nations. The Act declared it to be the policy of the United States to maintain 25 per cent of its monetary reserves in silver and directed the Secretary of the Treasury to purchase silver sufficient to that end, subject to his discretion as to time, rapidity of accumulation and prices, and subject also to the limitation that the price paid should not exceed the coinage value of $1.29 an ounce. While the law appeared to stress the acquisition of silver rather than the advance of price, I think it

fair to say that the general interpretation was that the law had two ultimate objectives—to acquire more silver and to raise the price to $1.29.

The Law in Operation

With this mandate on the books, our government set out to buy 1,300,000,000 ounces of silver in order to realize the required ratio to gold. Later on, because of our imports of gold, this figure grew to over 2,600,000,000 ounces. This is more than one fourth of the existing stocks of silver outside of the United States, including coinage and the estimated hoardings of India and China.

Barely had we got started on this vast program before repercussions began to appear abroad. China was the first country to be heard from. When the program began it found China already in difficulties—the result of a period of speculation and over-expansion in 1930-31. At that time depressed conditions in the interior had caused an accumulation of silver in Shanghai and other coast cities, where the increased stocks, together with the fall in the price of silver then in progress, promoted a real estate boom and an increase of industrial activity. This had terminated late in 1931 when the depreciation of the pound sterling and of the Japanese yen left China with an overvalued currency. While in 1931 it took about two and a half Chinese dollars to buy one Japanese yen, by 1934 the Chinese dollar was actually selling higher than the yen. All this caused a loss of export trade, and as the remittances from Chinese emigrants also fell because of the depression, the balance of international payments became unfavorable, necessitating exports first of gold and later on of silver.

Hence China went through two years of deflation prior to the inauguration of our silver price-raising policy. Since Chinese exchange was tied to silver it appreciated further in terms of leading currencies, which in the meantime had depreciated. The result was the speeding up of the deflation, drastic deterioration of the balance of payments and an alarming exodus of silver from the country.

The Chinese government protested vigorously to our government, but without avail. Our purchases continued, until finally China was driven to the expedient of a sliding-scale tax on

silver exports. By this it was hoped to check the outflow of silver and control the rise of exchange.

Despite this first warning that the purchase program was having results contrary to the predictions of its sponsors, the pressure upon the Treasury for rapid execution continued, and speculators grew more and more confident.

This speculation reached a climax about a year ago. At that time the open market price rose from 54 to 81 cents, and the Treasury increased its buying rate for domestic metal from 64.64 to 77.57 cents an ounce. By this time the disturbing effects of the program were spreading rapidly. Conditions in China were growing worse. Efforts to halt the outflow of silver were fruitless, due to the profitableness of smuggling caused by the spread between the bullion value of the Chinese silver dollar outside of China and its controlled exchange value. Money was tight, banks were failing, trade was depressed, and confidence generally was at low ebb.

Because of the rise of silver prices, many other countries found their silver coinage becoming worth more as bullion than as coins. As a result such pieces were being melted down and exported. In April, Mexico, the world's leading silver producer, announced the withdrawal of its existing silver coinage in exchange for paper, debased silver and base metal coins. Similarly, many other countries, including Costa Rica, Guatemala, Ecuador, Colombia, Peru and Iran, were forced to replace silver coinage with other kinds of money, or to protect themselves in other ways against being denuded of their currency. Had prices gone 15 to 25 cents higher, the coinage of Spain and the vast quantity of silver rupees in India would have been threatened with the melting pot.

Silverware manufacturers and jewelers complained of the rising costs, while later in the summer the American Tobacco Association in a memorandum to Congress expressed disillusionment with promises that had been made that higher prices of silver would promote tobacco sales in China.

Apparently the Treasury was impressed by this widening area of unsettlement; at all events, it ceased after April to buy on a rising market. As soon as it became clear that prices had reached a peak, the dependence of the market upon the Treasury was fully revealed. Speculators hastened to unload

while the unloading was good. Only the Treasury stood between the market and complete breakdown. By August the price was down to 65⅜ cents, with the usual deflationary wreckage, including the closing of the Bombay bullion market.

For fourteen weeks the market held steady at this level under United States government support. Then came the final crash. For some time rumors of Chinese devaluation had been current. Silver had continued to be smuggled out of China in large quantities and there seemed no hope of stopping it. During October the Chinese dollar broke sharply from 37 to 30 cents, and on November 3 the Chinese government came out with its new plan. All silver was to be nationalized and turned in to the government in exchange for paper. Exchange was to be controlled. China was adopting a managed currency.

This action by the last of the great countries still loyal to the silver standard, followed shortly by similar action by the British Colony of Hong Kong, was a staggering setback to the American purchase program. There was talk in the silver party of sinister foreign influences. Actually we had only ourselves to blame. China did what any other country probably would have done, and what many gold standard countries had done before her. Clearly there was need for a revision of our buying policies. Accordingly, the Treasury in December curtailed its purchases abroad, eventually retiring completely from the London market where the buying had been concentrated. The result was demoralization of world silver markets and collapse of the price to 45 cents, which is about where it was when the purchase program was started.

And still we do not have the required amount of silver. All told, we probably have bought about 960,000,000 ounces, at an approximate cost of 57 cents an ounce. We have expended, therefore, about $550,000,000, of which over $400,000,000 has gone abroad. Meantime, the original requirements have doubled by reason of gold imports so that we still have over 900,000,000 ounces to go. And the end is not yet; our gold imports continue, and every $1,000,000 of gold calls for an additional 260,000 ounces of silver.

Effects of the Program

Let us summarize now somewhat more broadly the effects of the program.

First, the effects on silver: As frequently happens when prices are advanced arbitrarily, the raising of silver prices completely upset the normal balance of demand and supply. It curtailed demand in all directions, not only in the industries and arts and for coinage, but also in the great markets of the Far East where the requirements for ornaments, currency and hoarding ordinarily absorb 70 per cent of the newly mined output. During recent years, China has been a seller of silver, while Indian consumption, which should have increased with the improved economic condition of the Indian peasant during the past two years, has likewise declined.

High prices tended also to increase production, and, what is far more important, attracted huge quantities of secondary silver from all over the world. *More silver was demonetized and thrown on the market in the two years 1934 and 1935 than in the entire fourteen years following the war.*

And, finally, the demonetization of silver resulting from high prices has been responsible for the accumulation of new stocks of silver in the hands of governments, the eventual disposition of which is a matter of concern to the silver market. In China alone the government is reported to have acquired 500,000,000 ounces under its nationalization law, and more may be received. While Mexico, Peru and China, under the terms of the London Agreement, are not supposed to sell silver from coinage, nevertheless an eventual disposal of this newly demonetized metal will be threatening the market—unless, of course, confidence in silver is reëstablished and nations reëmploy it in their coinage.

In other words, from the standpoint of silver, the purchase program must be acknowledged a failure. It has given silver neither stability nor permanent enhancement of value. It has discouraged rather than encouraged its use. This experience seems to confirm the truth of the old saying that one's best friends may sometimes be one's worst enemies.

Second, the effects on silver standard countries: There is—or was—only one commercially important silver standard country —China; its trade amounts to only 2 per cent of total world trade. Although the fluctuations of Chinese trade and exchange are disturbing in some degree to other countries, they cannot be regarded as mainly responsible for world prosperity and depression. Moreover, higher silver prices, as we have seen,

did not increase the purchasing power of China. On the contrary, the value of Chinese imports fell off 24 per cent in 1934 and 11 per cent more in 1935. In addition, a friendly people was given cause for resentment against us.

With suspension of currency convertibility and lowering of the exchange rate to 30 cents, China has experienced relief from deflation, and conditions today are improving. The ultimate outcome cannot be foretold. General opinion is that China will be most reluctant to go back to silver without some assurance against a repetition of her recent experience. Many people believe that she will tie up to either the pound or the yen. On the other hand, China in her present state of economic development, with a large part of the population accustomed to the use of hard money, is poorly adapted to a managed currency. For this reason there is skepticism regarding the new plan, and many persons familiar with conditions in the country believe that sooner or later a return to a metallic money basis will be found desirable. It remains to be seen whether the government can command confidence in its policies.

Third, the effects in the United States: (a) It has resulted in the issuance of nearly $600,000,000 of new money in the form of silver certificates. Inasmuch as the quantity of new money was already in excess of demand, this new supply cannot be said to have been responsible for the increase in total money circulation over the past two years. This increase was caused by the greater demands of business; the new silver certificates in circulation simply have taken the place of some other kind of money which has remained in the banks, thereby tending to swell excess reserves to new high levels. (b) It has weakened the monetary base by adding a stock of metal which in time of stress is likely to be an unavailable asset. The objection to the use of silver instead of gold as backing for the currency arises from the fact that silver at $1.29 an ounce is itself a credit currency and therefore cannot properly constitute reserve. In the event of a demand for redemption of the currency to meet an adverse balance of payments, or sudden withdrawals of capital, as in 1931-32, it would be impossible to realize any such price on these silver stocks, if indeed they could be sold at all. Thus in the last analysis, the security and stability of the currency rests upon the gold stocks alone.

While today the gold stocks appear ample for any demands likely to be put upon them, this may not always be true should we go ahead on the assumption that silver reserves are as good as gold reserves as a credit base. Therefore, silver purchases by the United States to broaden the monetary base, to provide a means of taking payments of foreign debts, to promote exports or redistribute gold stocks are not in our interest.

Fourth, the international effects: In addition to the adverse effects already mentioned, our purchases of silver in London have imparted an artificial strength to sterling exchange. All this tends to increase confusion in the exchange markets, and delay stabilization. There are indications that our silver policy, and distrust resulting from it, are obstacles to any agreement upon currencies.

Present Buying Policies

At present the Treasury is continuing to buy domestic silver at 77.57 cents an ounce, but apparently is limiting its purchases abroad to the new production of Canada and Latin American countries. In so far as this new policy represents a withdrawal from competition for existing stocks of silver, the change may be considered to the good. Experience has proven that it was a serious mistake to buy without regard for the effects upon the stocks of silver money in other countries. But why are we continuing to buy any silver from foreign countries? With our gold stock above $10,000,000,000, or more than twice what it was during the 1929 boom, we have no need for more metallic reserves even if silver were suitable for that purpose.

Conclusion

In conclusion, a few words as to the future. We have an interest in silver for several reasons. It is one of our products, but of even greater importance to us is the part that it plays in our trade relations with the silver-importing countries of Asia and the silver-producing countries of the Americas. Stability of values is of utmost importance in trade relations, and to achieve stability prices must be permitted to find their natural levels. This country cannot advantageously maintain silver above the level at which other countries will accept it in international settlements. An attempt to do so will cause us to

acquire more than we want, lessen the support from other countries, weaken silver's position and therefore make for instability.

The importations of India and China long have been the chief support of the silver market. The silver policy of the United States, by forcing abnormal price advances, converted both of these countries into exporters—an unfortunate development. However, since the price has declined to 45 cents, India has resumed importations, apparently in response to demands for normal distribution. This is a favorable sign. On the other hand, China is not yet a buyer, and apparently there are stocks of Chinese silver still coming on the market. While most of this silver probably comes from unsold stocks in London, there is still a possibility of some smuggling out of China owing to the fact that the bullion price of the Chinese silver dollar continues above the exchange value of the paper dollar. Should China be forced to sell silver to support her managed currency, this too would be a factor in determining silver prices. Thus the situation in China is unfavorable to stability at present, although China's need for silver undoubtedly is greater than India's.

It has been demonstrated that rising prices for silver do not increase China's trade or her importations of the metal. Rather the reverse is the case. It would seem that the best policy for silver that this country can follow is to coöperate with the government of China first in discouraging silver exports from that country and then in restoring the conditions under which China was a continuous importer on a large scale. As better conditions develop in world trade, silver absorption by Asia may be expected to regain the former volume and even increase. The price will respond to the relations of supply and demand, as determined by production and trade.

As to the plans for the restoration of silver to a larger use as money or as bank reserves the world over, either by general international agreements, or otherwise, they must be considered to have received a definite setback, at least for the present, as a result of the attempt to force matters.

CREDIT CONTROL UNDER A RECOVERY PROGRAM

WINTHROP W. ALDRICH
Chairman of the Board, Chase National Bank, New York

IT is now the function of the chairman before throwing the meeting open to general discussion to draw some broad conclusions on the central topic we have been considering, "Credit Control under a Recovery Program". In doing so, I may perhaps refer to some of the material already presented by the speakers on the formal program and possibly differ in certain particulars with what may have been said. I would remind you that variety of opinion is one of the main advantages to be derived from these meetings of the Academy of Political Science. Pride of opinion we are supposed not to have; on the other hand, differences of approach and discussion are what is expected of us.

We have heard much on three principal points. We have been told, for example, that a vast volume of credit is available for use in the United States ready to be brought into play when the commercial banks in the first place and the Federal Reserve Banks in the second place are called upon to provide it. We have also heard how the Federal Reserve authorities have powers under the law to prevent an undue growth of credit or to check it when expansion is actually under way. And, finally, we have been told in more or less explicit terms that the chief agency in the United States which is now relying upon credit and which promises to rely upon it still further is the federal government itself.

Now I am far from wishing to disparage the value of those preventive measures or those brakes which can be applied in case of necessity. For my part I have proposed several times that one of those preventive measures be applied at once. I believe that the Board of Governors of the Federal Reserve System when the time comes, will have the courage to use the authority it possesses under the new banking act, and which the

Federal Reserve Board already possessed under the former banking act, to raise the reserve requirements of the member banks. I need not go into details here to show you how the exercise of this power would work if it were applied. It is to be noted here merely that I believe the principal advantage to be gained from raising the reserve requirements would be to put to one side one of the major elements of insecurity in our present situation.

To raise the reserve requirements is of course not the only way to deal with the excessive funds owned by the member banks which are now resting quietly in the Federal Reserve Banks, but which nevertheless are subject to withdrawal in a devastating flood. Another means of dealing with them, as you have already heard, is for the Federal Reserve Banks to sell to the market a considerable part of their holdings of government obligations. In paying for them the banks would draw down their deposits at the Federal Reserve Banks, and so tap off some of the material otherwise likely to descend in possible future floods. For my part I think this method, beyond a relatively small initial effort, should be held in reserve and that the instrument of raising the reserve requirements should be used first. But whatever the method, it is clear that a start should be made so as to forestall hasty and perhaps drastic action if the flood waters begin to rise. In all the discussions that have taken place in the last few months on this subject I have seen little to indicate that the cost of action now along either of these lines would amount to more than what one might call a very modest insurance charge.

Now let us consider this question of control from the other side of the picture. What we are thinking about is whether it is not the government's business and duty to step in and perform a major act of regulation. We have heard a great deal ever since the war about the restraints and controls which government ought to exercise over the lives of the people. We have made some unsuccessful experiments of that sort in this country ourselves. I am beginning to wonder whether we have not been asking too much of the government and too little of the citizens. In shifting to the shoulders of the government sole responsibility for credit control, for example, are we not shirking responsibility which is in large part our own? In

urging Congress to pass laws, and in urging the executive officers of the government to control credit under the authority of those laws, we are really asking them to take a line of action which we should be following ourselves.

This is only a small part of a very broad question. A long speech could be delivered on it, which would go to the very roots of popular government. In general, it can be said, and the truth of it has been proven many times over, it is hard to execute a law, no matter how carefully drawn, unless it expresses the conscious and widely accepted will of the people. For one reason, if for no other, the administrators of the laws like ourselves are fallible human beings. In this matter of credit control, for example, not only the present law but its predecessors have given very wide room for the influential exercise of authority. But the tragic truth is that almost invariably action has been taken too late, and the Federal Reserve authorities have been behind the advancing forces rather than in front of them. This is not to be taken as criticism, but as a statement of fact which I think is inherent in the situation. The reason is not hard to find. Restraint upon credit expansion when exercised from above is necessarily so unpopular that our public officers, however able and however far-sighted, do not want to exercise it until everybody else sees the storm as clearly as they do. And then if they take action at last, it has to be drastic if it is to be effective. And if it is very drastic and very late the results may be almost as bad as the storm itself.

So I think we should not put too much reliance on the controls which depend upon official action. We have a part to perform ourselves. One would think, with the experience of the last few years so freshly in mind, that most of us would know our part and go ahead and perform it. Both banks and the customers of banks have lost a great deal in these years because of the abuse of credit. We now have an unexampled volume of credit ready for use. It must not be used wrongly, or else the abuses will do us perhaps even greater damage than they did before. Bankers, in doing their duty to their banks and to their customers, will, I hope, study the loans they make and subject them to the severe test of soundness. If they yield too far to the pressure to make earnings — a very general

temptation in these days—they will contribute to the erection once more of an unwieldy and top-heavy structure of credit, with very uncomfortable results for everybody. And the users of credit, those who seek to get from the banks some part of this vast volume of credit now in excess supply, must for their part exercise restraint upon themselves, so that their demands pass the necessary credit tests.

I indicated a few minutes ago that the largest user of credit at present is the federal government itself. It is the principal spender and the principal borrower. Many of the state governments in their own spheres are also great spenders and great borrowers. What I have said about private borrowers, and the need for them to exercise restraint if we are to avoid the evil consequences of credit abuse, applies to the federal government and the state governments with even more emphasis—federal deficits and state deficits, and the loans which they appear to make necessary, furnish the inescapable mechanism by which our vast store of dormant credit is slowly becoming active. As the process creeps forward, the danger increases that the forces will again get out of hand, to the lasting injury of the people as a whole. If anyone looks ahead, whether an arm's length or a lifetime, there is no more pressing patriotic service in sight than to curb public spending and especially public borrowing. No patriotic American can afford to close his eyes to this need, or to overlook the lesson for himself.

REMARKS BY THE CHAIRMAN

MR. WINTHROP W. ALDRICH: We can now proceed with the discussion of the papers to which you have listened. I would remind you that the Academy invites free discussions, provided, of course, that they are relevant to the general topic of the meeting. The rule is, as you will of course remember, that discussion by any one speaker is limited to a maximum of five minutes.[1]

Our half hour or so of discussion of the papers this morning will be introduced by the Associate Professor of Banking in Columbia University. Bankers know him not only because of his books on the Federal Reserve System, the Canadian banking system, and the New York money market, but because he is Educational Supervisor of the New York Chapter of the American Institute of Banking. I take pleasure in introducing Professor Benjamin H. Beckhart.

[1] Space limitations make it impossible to print in these PROCEEDINGS the interesting discussion by several members who spoke from the floor under the five-minute rule.—ED.

DOMESTIC ASPECTS OF CREDIT CONTROL AND THE RECOVERY PROGRAM—DISCUSSION

BENJAMIN HAGGOTT BECKHART
Associate Professor of Banking, Columbia University

THE addresses at this morning's conference have been devoted to the domestic aspects of the general problem of " Economic Recovery and Monetary Stabilization ". The selection of this particular topic would suggest that a relationship exists between monetary stabilization and economic recovery. In my opinion the two are closely linked together and I doubt whether we can achieve an enduring and healthy recovery without an international stabilization of the world's currencies in terms of gold.

One cannot but regret the great opportunity rejected by the American government at the time of the London Economic Conference, to bring about a stabilization of the world's currencies. The refusal of the American government to enter into a stabilization agreement has been one of the most important factors in delaying recovery. Instead of contributing to world economic rehabilitation, we have followed the Pied Piper along the primrose path of inflation, with the prospect of an unhealthy speculative type of credit boom in the offing.

Through the devaluation of the dollar we have subjected the gold bloc currencies to a heavy strain, and have given an impetus to additional restrictions on international trade. We have engaged in a fantastic silver purchase program which, as shown in Mr. Roberts' penetrating exposition of the subject, has had most unfortunate results. We have created huge federal deficits for the avowed purpose of priming the industrial pump and of raising the national income, only to find that the reduction in the volume of unemployment has been disappointingly small. Never in the entire history of the United States have monetary measures of such far-reaching importance been adopted with an equally reckless abandon or

with such complete disregard of their effect on domestic and international relationships. The policies followed have neither been good economies nor have they been consistent with a " good neighbor " attitude in international relations.

Regrettable as the past policies have been, we cannot eliminate all of the harm done nor can we completely retrace our steps. In view of the developments which have taken place, a return to the former weight of the gold dollar would introduce new problems, new dislocations and strains in our economic system, and would force the business community to face new unknowns. We must make concessions to practical expediency and in a realistic fashion face the problems presented.

What then are the main monetary and credit problems confronting the American people? Summarizing this morning's addresses, it seems to me that the main problems are three in number:

(1) *The problem of excess reserves.*—The growth in excess reserves over the past two years has resulted in larger part from gold imports and in smaller part from the silver buying program. The imports of gold are themselves a reflection of an unbalanced world. A shift of the magnitude which has taken place is without precedent.

As large as has been the increase in excess reserves over the past two years, an increase of equal magnitude can occur in the future through the use of the profits of gold devaluation in meeting the general expenditures of the government and through the creation and use of profits of silver devaluation following upon a revaluation of the silver dollar.

The potential credit expansibility upon the basis of the present excess reserves staggers the imagination. It is altogether too likely that the potential credit expansibility will become translated into an actual credit expansion. Experience in the past has demonstrated that American banks always expand to a maximum upon excess reserves. This was true after the reserve requirements were lowered in the original Federal Reserve Act and after they were again lowered and their character changed in 1917. The problem of excess reserves constitutes the heart of banking and monetary problems at the present time.

(2) *The problem of artificially low money rates.*—The low money market rates are not the result of an increase in savings but are the direct consequence of monetary manipulation on the part of the Administration. Bank earnings are adversely affected and banking institutions are under great pressure to expand their earning assets. Over-investment will be stimulated and capital inflation engendered. The low rates of interest will induce corporations to borrow to install mechanical equipment. Greater reliance will be placed on machinery, less on labor. Unemployment will not decline as production increases.

(3) *The problem of the federal deficit.*—Since June 1933 the direct debt of the federal government has increased by six billion dollars. In the main federal obligations have been sold to banks. No serious effort has been made to sell government obligations to investors. On the basis of their excess reserves, artificially induced, the banks of the country have been coining the federal debt into purchasing power. The dangers involved in financing the deficit on the basis of creations of bank credit were given proper emphasis in the address by Mr. Robey.

In this field of public finance there are two additional disturbing problems: In the first place, the deficit has remained the same despite the large increase in tax receipts. The increased tax collections have been absorbed by increases taking place in the general expenditures of the government. In the second place, the low rates of interest at which the government has financed its floating debt cannot continue indefinitely. Money market rates of interest will rise at some time in the future. When this occurs the government will find itself in a very precarious situation by virtue of the large amount of the floating debt which will have to be refunded at higher rates. This will throw the budget further out of balance. In other words we shall face the same sort of crisis which confronted the French government in 1926.

Such then are the main monetary and credit problems at the present time—the problem of excess reserves, of artificially low money rates and of the federal deficit. Excess reserves are the

basic problem, for without excess reserves, rates of interest would not be artificially low and the government could not sell its obligations to the banks.

In view of the monetary measures which have been initiated by the government and in view of the existing problems, what can be done? To prevent further harm I would suggest the following as a positive program:

(1) The Administration should make a definite promise that the present weight of the dollar will be maintained. In view of the large monetary gold stock in the country, the gold coin standard might well be introduced. At the same time the Administration should express a willingness to participate whole-heartedly in a world economic conference looking towards the stabilization of world currencies in terms of gold and a lowering of tariff barriers.

(2) The silver purchase enactments should be repealed. The Administration should withdraw all support from the silver market.

(3) The profits of gold devaluation, now assigned to the stabilization fund, amounting to $1,800,000,000, should be used to retire that part of the government debt held by the Federal Reserve Banks. The use of the profits of gold devaluation in this fashion would not affect member bank reserves and would rid the Federal Reserve Banks of a large part of their illiquid portfolio. This was the use to which the profits of gold devaluation were applied in both France and Belgium. Can we afford to be less conservative?

(4) The next recommendation involves the raising of member bank reserves. The Board of Governors of the Federal Reserve System might well use the powers conferred upon them by the original Federal Reserve Act to broaden the classification of central reserve and reserve cities. All cities in which Federal Reserve Banks are located should be made central reserve cities and many country towns should be designated as reserve cities. Upon the completion of this task, the Board of Governors could make use of the powers delegated by the Banking Act of 1935 to raise reserve requirements.

(5) The last recommendation involves the balancing of the federal budget. This point is all-important. Unless the budget is balanced, none of the controls enumerated by Professor Rogers will be used. If fiscal inflation leads to large gold exports, it is very likely that we will devalue the dollar again.

Balancing the federal budget will not be easy. Even assuming a change in Administration in January 1937, it will be difficult to reduce expenditures. The rigidity of expenditures is a trait common to all governmental budgets.

The ease of balancing the budget will not increase as time goes on. Indeed, if inflation is allowed to proceed, it will become more difficult. Government expenditures, by virtue of the increase in prices, will outstrip government receipts. Rapidly rising prices will encourage the deferring of tax payments.

The measures suggested point in the direction of the qualitative control of credit. The balancing of the federal budget along with the other measures will check credit inflation and will restore independence to the Federal Reserve System. Qualitative standards should replace attempts at quantitative control, which in the past has always involved a qualitative deterioration in credit.

I am not optimistic that the measures as suggested will be adopted, but without their adoption I am convinced that credit inflation will proceed. Bank portfolios will become further clogged with government obligations, with various types of investment securities and with real estate loans. The inflation in credit will proceed merrily until the next crisis. I do not wish to be a Cassandra but if we expand credit to a maximum upon the presently existing excess reserves, the next crisis will make the late unpleasantness seem mild by comparison.

PART II

CURRENCY MANAGEMENT AND THE GOLD STANDARD—INTERNATIONAL ASPECTS

MONETARY UNCERTAINTY AND CONFUSION *

ADOLPH C. MILLER
Member of the Federal Reserve Board, 1914-1936

NO one can look out upon the world today without being profoundly disturbed by the continued uncertainty and confusion which the monetary scene presents. More and more it is coming to be appreciated that the economic recovery of the world is being delayed by this continuing uncertainty.

How did this uncertainty and confusion come about?

The uncertainty has resulted from the all but universal suspension of the gold standard during the course of the depression.

After the suspension of gold payments countries fell back upon national currencies. These were paper currencies. Each country adopted the form of currency it thought best suited to its condition and needs. The result was monetary confusion, where before the suspension of the gold standard there had been simplicity and similarity.

How may an end be brought to uncertainty and confusion?

By a return to the gold standard, answers one school. By the establishment on a permanent basis of a new monetary régime, answers another school—by currency management, as they call it.

* Introductory address of the presiding officer opening the second session of the Semi-Annual Meeting of the Academy of Political Science. After broadcasting this address, Mr. Miller presented, toward the close of the session, a more detailed discussion of the history and future potentialities of the gold standard, *cf. infra*, pp. 83-92.—ED.

Between these two broadly contrasted and competing points of view lies a gulf, but not nearly so wide a gulf, be it noted, as is frequently supposed when we get down to the substance of the matter. To a certain extent the contest is between an old or older point of view and a new or newer point of view.

To most men of the generation which came to maturity before the World War, sound money, good money, meant just one thing—it meant gold standard money, that is, money based on gold and redeemable in gold, money which was " real " and had a definite meaning, money that above all had the priceless quality of certainty.

There are people who think that this is all there is to the gold standard—just so many grains of gold to the dollar if anyone wants to insist upon his pound of flesh—but this is a narrow, technical, legalistic view, altogether too much so to fit the facts of our day, though it might perhaps have sufficed as an account of the gold standard a hundred years ago. That standard has, however, long since taken on a larger meaning than that of merely giving clarity and certainty to the " obligation of contract " expressed in terms of money. If it is a footnote to any philosophy it is to the philosophy of economic integration and monetary orderliness. It has become very much more than a mere footnote to the philosophy of contract. It became in the course of time, as will be more fully developed later, as it grew to maturity, a piece of monetary mechanism, international in its scope and influence, for giving to the world a common form of currency, thus facilitating trade and financial transactions and the flow of investment capital among the nations; a mechanism capable at the same time, through good operation, of meeting the requirements of good national or domestic currency. The so-called central banks which existed in nearly all of the gold standard countries were integral parts of the gold standard system. It was a part of their recognized responsibility to watch over the gold standard and, within such limits as were admissible under it, to intervene at times in its operation, so to speak, to temper the wind to the shorn lamb in order to reconcile domestic currency requirements and the international currency requirements with one another. It is a mistake, and a serious mistake, to think, as many still do, that that monetary mechanism is a purely auto-

matic mechanism, or that the gold standard could safely be left to its own devices. There was therefore an element of management in it, and that element grew as the world grew, especially as the world grew more complicated in its economic structure. Nevertheless, in pointing out the broad differences between the gold standard system and the so-called managed currency system, it should not be overlooked that there were limits of tolerance within which management or discretion might be exercised under the gold standard system. While these limits had a considerable degree of elasticity, they nevertheless existed, and the fact of their existence broadly differentiated the gold standard system from the so-called managed or free currency systems.

There is neither time nor is there need of reviewing the record of the gold standard in this brief survey. It is enough to say that the fact that it endured as long as it did and won the esteem and confidence of the whole world is evidence that the old gold standard did a good job in its day. Let us turn, then, to managed currency, examine its nature and take a look at its recent record in the United States.

To many men of the generation which has come to maturity since the war the gold standard does not possess the magic meaning which it has for many of the older generation. By good money many people nowadays mean what is being called managed money, and by managed money they mean, of course, well-managed money, rationally managed money, money managed by men who know what they are about. The men to whom they would entrust the management of money are expected so to manage it as to insure perpetual prosperity by never putting out too much money, by never letting the public have enough money to go wrong in good times nor so little as to force deflation in slack times. Under this conception managed money might be described as "human nature money". Fundamentally that is what managed currency comes to. It means in practice, as its critics contend, that unless the men who do the managing are always wise men, and wiser men at least than those to whom our government has usually committed the determination of its destinies, the money of the country might have a good quality under one administration and a poor quality under a succeeding administration—might be what has some-

times been characterized as " political money ". Under this conception all would depend upon whether you or I were in command of the monetary mechanism. It might mean my stupidity today against your intelligence tomorrow; my good and easy-going nature against your prudent and careful nature; my poor judgment against your good judgment; my weak character against your strong character; in other words, money just as good and just as poor as the men who did the managing. Back of managed money lies, of course, a monetary philosophy, an interesting philosophy, an idea and belief that economic conditions can be made and altered and human behavior on the economic plane governed and controlled through the skilful manipulation of the monetary mechanism of any country with a highly developed credit and banking system. That philosophy has supplied in some sort and to some degree the inspiration and the objective which have shaped currency management more or less in most countries during the past few years and, it should be noted, with evidences of remarkable success in some. Great Britain, among the larger countries, supplies a striking example of such success, as does Sweden among the smaller countries.

Let us take a look at our own experiment in managed money.

When it comes to our American experiment in managed money it is not possible to speak with the same confidence: opinions differ, and will probably for some time continue to differ, with regard to the success of the monetary policy which has been developed and pursued in our country during recent years. There were those who confidently predicted that if the country's money supply was sufficiently increased and sufficiently rapidly increased it would float us out of the depression and lift prices up to the much favored 1926 level. The broad objective of our policy has been to raise the general level of prices and to ease the strain of private indebtedness by insuring an abundant supply of money to the country. The Federal Reserve System has, through the open-market policy which it pursued with energy, that is, the policy of putting out new and additional money for the use of the country through the purchase of United States government securities in the open market, made a large contribution to the increase of our national supply of money. Our revaluation of gold in 1934

not only increased the dollar value of the existing gold reserves but was followed by purchases of gold from abroad and from domestic mines amounting to more than three billion dollars, and under the Silver Purchase Act the country's supply of silver money has been increased by more than half a billion dollars. These huge accessions have given rise to what are called " excess reserves " of the member banks of the Federal Reserve System. Excess reserves are made up of the money which the banks have to their credit with the respective Reserve Banks in excess of the reserves they are by law required to hold in order to carry on their business. They are, therefore, in the nature of surplus cash owned by the banks, and can properly be described as idle money.

The total effect of these policies and changes has been to bring about a condition of extreme " money ease ", as it is called. Rates for borrowed money for commercial use have never been so low for those who could get it. Rates for money borrowed by the government have been unprecedentedly low. So far as there is restorative virtue in cheap and abundant money, it looks as though the United States ought to have had the full benefit of the monetary and economic theories of those who insist that the cure of business depression is a superfluity of money.

The abundance, however, or, better said, the superabundance, has not been without some effect in creating grave anxiety in the minds of some as to the future safety of our currency. To date, as a matter of fact, neither the hopes nor the fears which have been occasioned by this great increase of money supply have been realized: both appear to have been greatly exaggerated. The inflation that was not only hoped for but confidently expected by some, and as confidently expected and feared by others, did not result—at any rate has not resulted thus far. And why? Let us see!

Our recent experience has again demonstrated what the history of money and prices in the past had already established —that increases in a country's money supply do not automatically raise prices and stimulate business activity. The country was not lifted out of the depression, nor were prices lifted to the 1926 level by the device of increasing the supply of money. It takes time for a change in the supply of money to exert its influence upon prices. Moreover, to what extent it will affect

the course of prices depends upon a great many circumstances. Money affects prices and business only as it is used. Money does not possess the power of spontaneous activity. The dollar works only as someone puts it to work. Money is a tool: it has often been described as an instrument of exchange or a means of payment. Like other tools, it exerts no effect until it is used. Idle money, like idle labor or an idle tool, produces no effects. It is the money which is used and passes from hand to hand, not the money that is merely in the statistical picture, that counts in affecting the volume of business or the movement of prices. When the economic outlook of the country is uncertain for any reason, when people are apprehensive for the future, they will hesitate to use their money; they will hesitate to buy or invest with the money which they own and they will also hesitate to borrow money, just as lenders will hesitate to lend. The leaven of faith in things present and future is what vitalizes and activates money. It is the ferment of enterprise that puts money to work. Where there is no peace of mind there will be no enterprise, and industry will drag. This world of ours, notably the economic and business world, moves forward only in the atmosphere of hope.

Broadly speaking, the net effect of our monetary policies as recovery-stimulants or depression-cures has not been noteworthy— certainly not when set against the background of the promises confidently made by their sponsors at the time the policies were adopted—but their effects in adding to and prolonging monetary uncertainty and confusion and the suspense of mind which these breed have been noteworthy.

The time is at hand, therefore, if not overdue, when the most competent thought we are capable of in the United States should be given to the question of how monetary uncertainty and confusion may be terminated in our own country, and the world at large as well as ourselves again given a monetary system enjoying an assured and incontrovertible position. Sober reckoning should be taken of what continuing monetary unsettlement is doing to keep alive the forces of doubt and hesitation. There is no other equally important contribution to economic restoration that can be so easily made as the termination of this monetary uncertainty. Shall it be by a return to gold in some form, or shall it be by going on with managed currency?

REMARKS BY THE CHAIRMAN

MR. ADOLPH C. MILLER: The first of the speakers is Mr. Robert Warren, for several years on the research staff of the Federal Reserve System, first with the Federal Reserve Board in Washington, later with the Federal Reserve Bank in New York, and now an economic adviser to the private financial house of Case, Pomeroy and Company. It is a pleasure to introduce Mr. Warren.

THE WORLD CURRENCY MUDDLE

ROBERT WARREN
Case, Pomeroy and Company

MONEY is but one element in a political economy—an important element, but only an element. There were organized states with developed political economies before money came into existence. If money be admitted at all as an element of a political economy, it is admitted, not as something in itself, but as an element conducive to certain economic objectives sought by society. Because it is an element, it becomes contributory to general social objectives; admitted into an economy, it becomes to a degree a determinant of social objectives. Once the objectives have been defined and accepted, it is a comparatively simple matter to devise a monetary mechanism to further their realization. Until these objectives have been defined and accepted, discussions of monetary mechanisms remain hardly more than exercises in economic casuistry. Nine tenths of the current discussion on money concerns mechanisms; nine tenths of the problem itself concerns objectives.

Little is gained by a consideration of methods, mechanisms and technique until one has discovered the premises and the objectives. Little is gained by discussing ways and means of restoring or improving the gold standard, until we have first determined whether or not we wish to have any kind of gold standard at all; as there is little point in debating whether this or that group of individuals should be responsible for the management of our currency until we have resolved the preliminary question of whether or not we wish a managed currency.

From the outset, the very fact of money encounters a conflict of social objective; for we will recognize at once that there are two primary social objectives in international relationships—the so-called internationalist objective and the so-called objective of economic nationalism. No matter what kind of money system we create, it will have points of tangency with

and impact on the money systems of other nations. Strictly speaking, no nation can have complete freedom of monetary action. It can only have more or less freedom. Whether our chosen policy be that of internationalism or that of national self-sufficiency, our money system will be either in harmony with that policy or in conflict with it. It cannot be segregated from it. Nothing could be more inconsistent than to adopt a money system whose utility largely presupposed intimate economic relationships with the rest of the world, and at the same time in all other respects to adopt a policy of isolationist self-sufficiency. For a time, the conflict might not be acute. In the end the one would be forced into conformity with the other, but at an economic cost. To cite a concrete example, we all know that in England there has been for years a lively conflict of social objective between those who were chiefly concerned for a higher price level, and those who were chiefly concerned for a pound stabilized with reference to foreign currencies—a conflict between those who were regarding money primarily from the nationalist standpoint and those who were regarding money from the internationalist standpoint. We do not know to what extent the British authorities might have been successful had they elected to pursue the first objective. We know that they have been quite successful in realizing the second objective; and that they have made no appreciable progress toward the first. Yet they have neither committed themselves to one, nor formally renounced the other.

In the absence of agreement concerning objectives, we take refuge in ambiguity. We speak glibly of sound money, but in the abstract the adjective is almost meaningless—a money is sound as it is conducive to an accepted social objective. If the *accepted* social objective of England were a rapid rise in the price level, then the British policy of maintaining the stability of the external relationships of sterling has been unsound. If I assert that a sound dollar requires instant, unlimited and unquestioned convertibility into gold coin on demand, I mean first that I consider that kind of dollar to be conducive to a certain complex of social, economic and political objectives which I regard as most likely to promote the welfare of the people of America; and second, that no other type of currency would be equally conducive to those objectives. If I rate such dollars as

sounder than greenbacks, it is not because of something inherent in either, but because of a consideration of their competitive utility with reference to certain social objectives. Nor is it sufficient that I arrive at such a preference on the basis of traditional authority or on the basis of personal interest. Unless I am intellectually lazy, I shall have precisely defined the exact social, economic and political objectives served by such a dollar—and taken into account the various adjustments that would be required to bring our economy into harmony with it. But the objectives that seem desirable to me may seem undesirable to you; or you may acknowledge the objectives to be meritorious, but not worth the costs of readjustment, so that the dollar which I would describe as sound, you might rate as unsound, and vice versa. In short, when we speak of "sound money", we are speaking in the first instance subjectively; and objectively only to the extent that our individual views coincide with the accepted social objective, and have accurately defined the monetary mechanism most likely to promote it.

Putting it quite bluntly, if the world, or a group of countries, or if you please, a single country had a clearly defined, commonly accepted social objective—if it could agree upon the function which it expects money to perform, as an element of its political economy—it would be relatively simple to devise a money system which would harmonize with and be conducive to that objective. It is the absence of such agreement that brings the twentieth century into such sharp contrast with the nineteenth century.

Now, by and large, during the nineteenth century the Occidental World was in general agreement on certain social, political and economic objectives. Three of them may be enumerated.

1. In trade and production, the doctrines of laissez-faire economics were generally accepted.
2. In international relations, in spite of the wide use of protective tariffs, the general philosophy was the encouragement of the international exchange of goods—which was enormously facilitated by the improved communications adopted during the century.
3. In government, there was a general tendency, deriving from the three great revolutions of the previous century,

to limit the state to rather narrow boundaries; and specifically, after the experience with the assignats in France and the Continental currency in the United States, the relation of the state to the money system was strictly limited.

These were, let us say, a set of bourgeois objectives; but the nineteenth was a bourgeois century. Before its birth, it was described by Edmund Burke: "The age of chivalry is gone; it has been succeeded by an age of calculators, sophisters, and economists." That is quite accurate—Adam Smith was the prophet of the nineteenth century, and Queen Victoria was the incarnation of its theory of the state. Further, it was a century that took peace for granted. Waterloo and the Marne bracket the most peaceful century Europe had known since the death of Marcus Aurelius.

It was against this background that the gold standard rose and flourished—its automatic functioning was in proper accord with the ideals of laissez-faire economics; its universal and unvarying interchangeability accorded with and promoted an ever-expanding volume of international trade; its disciplines and limitations were of actual assistance to a society whose objectives included the restraint of the aggrandizing tendencies of the state.

Already we can say with some positiveness that the accepted objectives of the nineteenth century are not the accepted objectives of the twentieth century. Whether these objectives are stated in terms of Social Democracy as in Russia, National Socialism as in Germany, the Corporative State as in Italy, the Cartel System as in France, the Trade Association System in England, or the New Deal in the United States, the survivor of the nineteenth century finds himself in a different world.

Wide as is the diversity among these systems, they have three things in common: in economics, rejection of the doctrines of laissez-faire; in international relationships, the prohibitive tariff, the embargo, the quota and even the quarantine are evidence of the extent to which the objective of economic nationalism has replaced the objective of world trade; and while the scope of the state varies widely between, let us say, Russia and England, Italy and the United States, in all countries it has assumed proportions which, while they would

seem familiar to a burgess of the fourteenth century, would seem incredible to a citizen of the nineteenth century. In the nineteenth century, the social objectives of England, Russia, France, Germany and the United States were fundamentally in agreement with each other, although this agreement was expressed in a variety of forms. The same fact may be stated today. The great nations of the white race exhibit remarkable diversity of form in approaching their objectives, but fundamentally there is more similarity than difference.

But the common objectives enumerated above are as yet negative objectives. All these states have rejected laissez-faire economics; but except Russia, none has defined in positive terms the ideology which is to replace laissez-faire; all have adopted doctrines of economic self-sufficiency—yet all are deploring the success of their collective efforts. All have demanded that the boundaries of the state be enlarged, but none, except Russia, has clearly delimited the new boundaries, and even in Russia they are shifting.

Now, not for one moment would I attribute the abandonment of the old objectives, or of the philosophy of money that went with them, to the wiles of the demagogue or the machinations of sinister forces. They were abandoned under duress, of which I would specifically enumerate three forms:

1. A burdensome, and, for some states an intolerable, debt structure largely inherited from the war.
2. An experience with price fluctuations beyond anything which organized society had hitherto encountered, at least since the third century.
3. A phenomenon of unemployment which was far beyond the experience of the nineteenth century.

Under the duress of these circumstances, it is easy to understand why society has cast aside its old gods, and sought new ones; and it is equally easy to understand why in the money mechanism it seeks changes which promise to alleviate the specific woes of which it is most acutely conscious from recent or current experience, namely

1. Unemployment.
2. The burden of debt.
3. The menace of violent price fluctuations.

It is out of consideration of these three oppressive problems that three schools of monetary thought have developed, in place of the single school whose opinion was generally accepted in the nineteenth century. Each is equally aware of the triple problem, each is equally social-minded; all are equally radical, in the true sense of the word, in that they would strike at the very roots of this triple problem, rather than resort to temporizations and expedients. All agree on one fact—that a money system, must have an accepted point of fixation, beyond political caprice or economic opportunism. The disagreement lies in the point of fixation.

1. One school would make some accepted domestic price index the point of fixation. That is, it would endeavor to attain some optimum domestic price level, and thereafter orient the whole force of monetary policy upon the maintenance of that level. This is essentially a program of monetary nationalism.
2. A second group would make the rate of interest the point of fixation, and the whole force of monetary policy would be directed upon establishing and maintaining an optimum interest rate calculated to effect some desired utilization of the credit mechanism. This, too, is essentially a program of monetary nationalism.
3. The third group would make the maintenance of a set of international currency relationships the point of fixation, maintaining these relations through the familiar mechanisms of the gold standard, although it will be realized that there is little agreement yet as to the rates of exchange upon which currencies might permanently be stabilized. This represents a program of monetary internationalism; and as such it imposes disciplines decidedly limiting freedom of national action.

Of these three schools, the last probably commands a more numerous popular allegiance than either of the alternatives. But both in Europe and in this country, the price-level standard has strong support; while in England a new point of fixation is coming forward among economists—the employment of the money mechanism to fix the long-term interest rate at some low figure, say under three per cent, and there to maintain it

without direct regard to the price level or to fluctuations of the foreign exchange. While this last theory has not received wide advocacy in the United States, there is no doubt that it could command a large following. If this country were suddenly confronted with the alternative of a 59 cent dollar and a five per cent interest rate or a 50 cent dollar and a maintenance of the three per cent rate, I dare say that we should find we are more deeply committed to this theory than the absence of discussion would lead us to suppose.

Time does not permit an argument as to the respective merits of these three schools, each of which has a legion of able protagonists. It is enough to point out that each recognizes one salient fact—that a money system must have somewhere a point of fixation, to which it is committed finally and definitely. For some months we have experienced (1) a stable price for gold with approximate stability of the foreign exchanges, (2) a stable price level, (3) a stable long-term interest rate, represented by a quotation of about 2¾ per cent on long-term government bonds. Which of these is our point of fixation? To which one of these are we most firmly committed, and which two are we prepared to sacrifice, if a choice must be made? For nothing in monetary history even suggests that all three can be maintained in their present and recent relationships definitely.

Or, I might add, if this country were suddenly confronted with the option of a 59 cent dollar with sterling at $3.50, or a 50 cent dollar with sterling at $4.87, would we demonstrate our allegiance to gold or seek admission to the sterling area?

If I were to ask this audience what kind of money it desired, I should get a unanimous reply, "Sound Money"; and if I further asked this audience what it meant by sound money, the reply would be, "Money of stable value". Such a reply would not be peculiar to this audience—an identical reply would be given by a comparable audience in London, or Paris, or Rome, or Berlin, or Tokio. But if I asked the third question, as to precisely what sort of stability is desired, what point of fixation commands your most sincere allegiance, the reply would be far from unanimous. Nor would I get greater unanimity in London, or Rome, or Berlin, or Tokio. Yet, unless a money policy is to be arbitrary, capricious and oppor-

tunistic, it must have some point of fixation; some last line to be defended at all costs. And the very fact of fixation in terms of one point presumes variation in relation to all other points. In choosing any one of the three, as our point of fixation, whether the price level, or the interest rate or the international relationships, we invite by implication the fluctuation of the other two.

The money muddle of the twentieth century lies in its inability, organized in its respective states, to determine upon a single point of fixation with the same resolution and unanimity as the nineteenth century determined upon and clung to the price of gold.

I have no doubt of the capacity of society so to organize itself as to realize the social objective of a stable price level; I have no doubt of the capacity of society so to organize itself as to secure the social objective of a low and permanently stable interest rate; I have no doubt of the capacity of society to organize itself on the premise of an unstable price level and an unstable interest rate, with international fixation on gold. I strongly doubt—more than that, I would deny—that any one of these objectives can be realized solely through the money mechanism. If stability of prices be the accepted social objective, our entire economy must be oriented on it. If an optimum interest rate be our objective, our money mechanism must be reinforced by a variety of social controls, all aimed at the same end. If stability of the international exchanges be the objective, then conflicting elements in our political economy must be eliminated or subordinated. And further, I must insist that no one money system will equally serve all three objectives; and any attempt to make it do so will only create confusion of purpose and invite the eventual disaster that is the penalty of divided objectives. Each of these social objectives promises some desired advantage; but we must be prepared to purchase that advantage at a cost.

The nineteenth century was at least able to make up its mind and was willing to pay the cost of its decision. It accepted fixation via gold of the international relationships, and paid for it with fluctuating price levels and fluctuating interest rates; and it accepted a political economy which was in harmony with its money policy—laissez-faire in production, internationalism in trade, and a limitation of the power of the state.

The twentieth century not only has not made up its mind, but finds fault with current monetary policies as determined by caprice and opportunism, without acknowledging that these policies reflect its own inability to choose between its three conflicting objectives. Government, whether in England, the United States or elsewhere, is in this case the faithful mirror of a public sentiment that day before yesterday insisted upon a money policy related to the domestic price level, yesterday insisted upon stability of the international exchange, and today upon a fixation of the interest rate. We throw shoes at the mirror because we do not admire our own reflection in the glass.

So far in this paper it has been my intent to present the theoretical phases of the monetary question; and especially to contrast the clarity and simplicity of the nineteenth-century concept of money with the confusion and complexity of the twentieth century. But such a presentation omits what is, speaking realistically, the salient fact in the money muddle. Broadly speaking, in the nineteenth century nations balanced their budgets; at the present time, nations do not balance their budgets. I cite this fact, not for the purpose of arguing that the nineteenth century possessed a superior sense of fiscal responsibility, but for the purpose of emphasizing two reasons for this contrasting behavior. The two reasons for unbalanced budgets in the world are, first, military expenditures and, second, the relief of unemployment. Neither of these presented an acute problem to the national treasuries of the nineteenth century. Judged by contemporary standards, military establishments were puny and inexpensive in a century that took peace for granted; their cost was easily confined within the limits of taxable resources. Second, unemployment on a large scale was a brief and infrequent abnormality in a century whose basic concern was a scarcity of labor adequate to meet the demands of its geographic expansion. In that century no treasury was called upon year after year to keep a nation-in-arms on a war footing or to provide for the maintenance of a large fraction of its population. To speak bluntly, the nineteenth century balanced its budgets because it could, or did, take peace for granted, and because it had no problem of unemployment. The twentieth century does not balance its budgets because it dares not take peace for granted and because

it has a problem of unemployment. Even without these special expenditures the routine costs of every state require taxation which the nineteenth century would have regarded as ruinous to economic progress. With these special expenditures, deficits the world over have become so large as not merely to exceed the taxing power of the state, but to exceed its borrowing power unless the state can make the monetary system the adjunct of the fiscal system. In the catechism of the contemporary state, the chief end of monetary policy is to finance the Treasury. In the stratosphere of academic theory, we may discuss the merits of the gold standard, or explore the possibilities of managed currencies designed to guarantee that price level or this interest rate. But on the hard ground of current actuality, these discussions are irrelevant except as they are related to the immediate problem of the financing of the Treasury deficit or its counterpart, the support of a Treasury debt representing the accumulation of past deficits.

As I see it, the world money muddle is a dual problem. There is the problem as it presents itself to the economist seeking among several options the ideal money system. But there is also the problem as it presents itself to the finance minister confronted with a budget that he cannot meet except by exploiting the money system in the interest of his Treasury — commonly with a deficit caused by demands for the national defense or by demands for the relief of the unemployed.

The theoretical aspect of the money muddle derives from an honest perplexity as to the basic concept of money best calculated to promote the social objectives of our time, on the hypothesis that we are free agents, able not merely to devise but to adopt the money system of our choice. The practical aspect of the money muddle derives from the hard fact that at the present time in no important nation does any such freedom of choice exist. In every major nation, the exigencies of the national exchequer demand and receive first consideration and dominate both the formulation of monetary policy and the operation of the monetary system.

REMARKS BY THE CHAIRMAN

MR. ADOLPH C. MILLER: Our next speaker is to be Mr. John H. Williams. Mr. Williams is well known as a student, particularly of international finance, and now occupies the Chair of Economics in Harvard University. He is as well qualified as anybody to talk upon the subject which he has chosen, "Monetary Stabilization and International Flow of Capital". I present Mr. Williams!

MONETARY STABILIZATION AND THE INTERNATIONAL FLOW OF CAPITAL

JOHN H. WILLIAMS
Professor of Economics, Harvard University

IN discussing the subject, " International Monetary Stability and Capital Movements ", I think perhaps the first question is whether we desire to have international capital movements. At the moment there is a great feeling of discouragement, not confined merely to this country. That comes, I think, in large part out of the experiences of the twenties and the depression that has resulted.

During the twenties, undoubtedly, we indulged in an orgy of international capital movements. Every war has been followed by such an orgy. It happened after the Napoleonic Wars. It happened after the Civil War. I have seen a list of foreign loans made by England following the Napoleonic Wars, and some of the countries on the list were so obscure that to me they were unidentifiable.

Perhaps this particular orgy is worse than any that has preceded. So far as this country was concerned, we found ourselves in a unique position. Unlike any other country preceding us, we had been thrust almost overnight into a new international position.

At the beginning of the war we were the world's largest debtor and by the end of the war, four and a half years later, we had become the second largest exporter of capital. I think a great deal follows from that sudden transition. We found that we had been making loans for non-economic purposes. We found we had been making loans that could not be collected, and very serious questions were raised as to whether they should be collected.

We developed a surplus of exports on an unprecedented scale. In four and one-half years of war our export surplus amounted to eleven and one-half billion dollars, which was equal to the sum of our export surpluses in the preceding forty years. As

a result also of the war, we found ourselves with large profits, with great savings, with greatly expanded industries seeking outlets abroad. America had become a reservoir of world capital and this reservoir was then tapped in every direction. It encountered an unusual, intensive and insistent demand abroad.

Part of the capital went into Europe for non-economic purposes. We all recall the extravagant movement of capital to Germany as a part of the reparations planning. Part of it went, under the auspices of the League of Nations, to Central European countries. Much of it went into the young countries of the world, the young agricultural countries which also found themselves greatly stimulated as a result of the war.

We found also all sorts of cross currents in our international lending. Though we had been thrust overnight into a new position, we still had many of the characteristics of a young country. We still found that our home investments were usually superior to the foreign opportunities for investment. We thus found ourselves twisted and torn between desire to invest abroad and desire to invest at home.

This contradiction affected the outside world as well. Our stock market boom was a characteristic phenomenon of a young country. It resulted in an inflow of funds from foreign countries into our country—a country which now in its new creditor position should have been exporting capital to the rest of the world, was actually taking capital in from the rest of the world. That, I think, was one of the major causes of the depression.

In addition to the long-term movement of capital, there developed after the war an unprecedented movement of short-term funds. It has been estimated that by 1930 there were no less than $14,000,000,000 of these short-term funds. They had developed in part out of the world's experiments with the gold exchange standard, and in part as a result of the reparations experience. In large part, I think, they grew out of currency disorder and fear. Currency disorder has the effect of shortening the period for which investments will be made. The investment of American capital in Germany began as long-term investment and then steadily shortened as time went on, and the outcome became more uncertain. The movement

of short-term funds continually rattling about the principal money markets became one of the most unsettling factors in the whole post-war monetary situation.

As a result of all these circumstances, it is not unnatural that our country for the time being should have turned its back upon foreign investment. I think, however, that that is a temporary phase, and that as time goes along and we enjoy a recovery, it will be a recovery not merely of domestic investment but also of international investment.

Perhaps the period necessary for reviving international investment will be longer. That was Britain's experience after the Napoleonic Wars. There followed a very considerable interval in which the British had not yet forgotten their burnt fingers and were unwilling to go on.

The principal reason that I have for taking this view is that I believe it to be a part of the inexorable economic logic applicable to the case. I think we shall find, just as the British did in the nineteenth century, that development compels us to go seeking investment opportunities wherever they may be found for just the same reason that we desire to buy goods where they can be had most cheaply.

If we take the longer view and go back through the nineteenth century, we can hardly doubt the desirability of international investment. It was by this process that England was able to build up labor and capital on so small an island. The advantages were cumulative. The economists frequently explained in their discussions of international trade adjustment how the terms of trade are turned against the investing nation. That, to my mind, is a shortsighted view, a cross-section, a static analysis. It entirely overlooks the fact of growth. The fact of the matter in the nineteenth century was that the movement was beneficial both to the receiving countries and to the paying countries. We, in that time, were on the receiving end. I think no one will doubt that we were benefited by international investment. By this process our interior was opened up, our railway net was built, our industry and agriculture were stimulated.

Cairns, the English economist, paints for us a picture of the long-time cycle of change. Nations in the beginning are borrowers from abroad. At a later stage, they are payers of

interest on balance. At a later stage, they are exporters of capital on balance. And in the final stage, they are receivers of interest on balance.

That picture of the long-time cycle of change often comes into my mind these days because it carries for us some interesting implications. The first is that underneath the whole development there is a presumption of productivity. Why does a nation change from a capital-importing country to an interest-paying country? Only because the application of the capital has been productive. It yields an income.

We now find ourselves in the third phase. We have been, until the depression, a capital-exporting country. I doubt if we have ever been a creditor country in the true sense, a country entitled to receive interest on balance. That is, I doubt if we have been a creditor country in the income sense, but we are progressing toward that stage without any question. The economic logic of our situation, of the world's situation, will force us on that path, even though at the moment we are surrounded by exchange restrictions, trade restrictions, capital export controls and all the other devices looking toward autarchy, the closed economy.

Thoughtful economists would dismiss a great deal of what I have said as obvious, even platitudinous. They say, "Of course, we recognize that international capital movements have been instrumental in the development of the world, its resources, its trade, but we have now reached a point where the world is sufficiently developed and we can afford to put our minds on other problems. International capital movements have been a source of economic instability." The problem of stability today is more important, according to these economists, than the problems of productivity.

That is a rather challenging point of view and there is a good deal in it. Unquestionably, though there have been many other causes of instability, international capital movements have been one of the chief ones. It can be illustrated in various ways how the movement of capital does create an unstable situation. For example, according to the simple classical theory of international trade, you always have equal compensation among the trading countries. If prices rise in one country, imports increase, gold flows out, prices fall, ex-

ports increase, until you again strike a balance of exports and imports. It is a beautiful self-correcting mechanism. Capital movements do not subject themselves to that analysis at all. If, for example, prices rise in a country, there are likely to be profits. The appearance of profits will attract international investment as well as home investment. The inflow of capital drives prices higher, makes profits larger for the time being, and there will be another inflow of capital.

So the thing goes on as in a spiral and this is true whether the phenomenon runs in terms of commodity prices or in terms of security prices as in our late stock market boom. The process continues until there is collapse, either in the capital-receiving country or by the drainage of funds from the lending countries. And that this thing could happen to a country which was already an exporter of capital under other conditions apart from that particular boom, is a very striking proof of the instability introduced into the world economic mechanism by capital movements. That is one method of proof.

League of Nations studies have shown, it seems to me, conclusively that nowadays booms and depressions are coming to be more and more simultaneous in all the leading countries. The explanation is not difficult. From the point of view of the capital-receiving country, I have already given the analysis. From the point of view of the capital-paying country, the export of capital will be followed or accompanied by an exportation of goods. This will make for industrial activity, at least in the export industries. There will then be a demand for credit and a boom can be generated not only in the capital-receiving country, but in the capital-paying country.

Of course, I recognize that this argument assumes the existence of free reserves in both banking systems. That was not allowed for by the strict gold-standard theorists who always supposed that banking systems were loaned up. But central banking is a complete answer to that assumption. Central banking is based upon the opposite principle, that it is prudent for a country to have some slack in its banking system.

The central bank plans always to hold an extra reserve and with that reserve it can influence the money market, so that under modern conditions there is plenty of room for simultaneous expansion. As to contraction, we have the evidence of

the depression itself. Surely we experienced a simultaneous world-wide contraction in the thirties, at least until 1932.

The phenomenon of short-term capital movement can also be used as proof of instability introduced by capital movements. We have seen, for example, in the twenties, England using the short-term capital movement as a means of balancing her account momentarily, in a purely temporizing way. Lending money long-term, she was borrowing it short-term, in order to avoid the loss of gold and the fall of prices and costs which she felt would be too painful.

The question to be faced, therefore, is how to effect the best compromise between the two considerations, productiveness on the one hand and stability on the other. The world is now in process of searching for the answer. The current British answer is the system of flexible exchanges. The general purpose of this system is not necessarily to do away with international capital movements but to protect the internal economy from the strains and hazards of such movements. It is based on the view that the stability of the internal economy must come first.

There is not time to discuss in detail the question of flexible exchanges. As a depression policy, adopted under conditions of world-wide deflation, there was much to be said for it; indeed under the circumstances there was no other course. But from a longer viewpoint, I cannot but think that the well-being of countries like England will continue, as in the nineteenth century, to be largely dependent upon international trade and capital movements, for which some reasonable degree of international monetary stability will be found to be essential. Perhaps if England and Germany and Italy were not just now preoccupied with internal recovery, resting upon such temporary phenomena as a housing boom in one case, rearmament in another, and war in the third, they might find themselves more sympathetic to this point of view.

Flexible exchanges, in my judgment, will not remove the unstabilizing effects of capital movements. They will put the emphasis on the speculative aspect rather than on the investment aspect of such movements. They are likely to give us the maximum of the undesired characteristics of capital movement and to minimize the desirable characteristics.

Now, for our own country. What should be the policy? My time is getting short. Well, what are the alternatives? We, too, could go in for flexible exchanges. But if we do not do that, should we leave international capital movements wide open or should we subject them to some measure of control? I am very skeptical of governmental control. In England today it is not possible to bring out a new loan without approval of the Treasury. Indefinitely continued, such a policy might raise many questions. In the long run, political, economic and diplomatic questions are intertwined. With governmental control of loans in this country we might hear a good deal more about imperialism and dollar diplomacy. Are governments going to hold themselves responsible for the mistakes they make in foreign investment? Are they going to collect with troops the loans which they sanction?

Two points should be remembered in any attempt to improve our record as international lenders. The first is to learn the job better. We need higher ethical standards as well as more thoroughgoing analyses on which to base our international lending. We have been too much interested in the salesman's concern whether the bonds that we took were salable, rather than whether they were sound in an economic sense. The second point is that, since international lending involves distance and strange conditions, it is a job for specialists rather than for the small investor or even for the small banker.

Finally, I believe that the central bank has an important rôle to play. Fundamentally the problems of foreign investment and home investment are similar. The task, in the large countries, is to learn and to institute an effective policy of monetary control. If we succeed at home, in all likelihood we shall succeed abroad as well. If we fail, we fail in both fields. In the twenties we were unable to stop the mania of investment either at home or abroad. We have had various new tools handed to us during this depression and surely we are equipped to do a better job, provided only we have the knowledge. I would like to end on that note. Instead of conflict, there is an essential harmony between the aims of internal and external monetary policy. You cannot have domestic monetary stability without some measure of international good health, and you cannot have international monetary stability unless you keep your house in order at home.

Remarks by the Chairman

Mr. Adolph C. Miller: We now proceed with our meeting, addressing ourselves now to the subject of "The Sterling Area and the Stabilization Problem". Our speaker is Professor Alvin H. Hansen of the Department of Economics of the University of Minnesota. Professor Hansen is a man who is well known to economists and particularly for his penetrating studies upon the business cycle, and his recent volume on "Stabilization in an Unbalanced World", that is, the world of today. We hope not the world of tomorrow.

I have great pleasure in presenting to you Mr. Hansen!

THE STERLING AREA AND THE STABILIZATION PROBLEM

ALVIN H. HANSEN
Professor of Economics, University of Minnesota

THE topics under discussion this afternoon relate to the international aspects of money. An international monetary system presupposes the existence of well-established international relations if not of a highly international economic structure. Such a structure had indeed developed to a rather remarkable degree in the nineteenth century and in the decade prior to the great war. But the pre-war international world was in a sense not international at all; it was essentially a British world. London was the commercial and financial heart of the whole system. Not only was England the center of a world-wide exchange of goods but she also was the major source from which flowed vast capital funds into North and South America, the Orient and other parts of the globe. Moreover, in the migration of populations, one of the leading characteristics of the pre-war century, England played by far the most important rôle. Finally the British pound sterling was essentially the world monetary unit, since commercial bills were regularly drawn in sterling. All the factors affecting the balance of international payments, foreign trade, the movement of long and short-term capital, and gold shipments converged at London.

The pre-war international system, which as I have indicated may properly be termed a British international system, was destroyed by the war. The post-war efforts at international coöperation sought to rebuild a new world structure on a genuinely international basis. Had it been possible to escape the terrific world depression, this end might indeed have been achieved. For the time being, however, the depression shattered this hope.

It is surely no exaggeration to say that of all the world-shaking events which have come out of the depression none is more revolutionary or far-reaching in effect than the withdrawal of England from the world international system, and the erection instead of a more limited British system, a system which is not world-inclusive in scope, but restricted to an area more directly and immediately subject to British control.

I refer, of course, to two striking events, one having to do with monetary matters and the other with trade matters. The establishment of the sterling area in 1931 means the emergence of a limited international monetary system covering, however, an important part of the modern financial and commercial world. Logically and consistently this event was shortly followed by the erection of a systematic scheme of imperial preferences at Ottawa in 1932. The groundwork for this structure had already been laid in part by earlier Dominion preferential tariffs and by the definite adoption of outright protectionism by England early in 1932. To complete the trade structure and make its area substantially coördinate with the sterling area, the Ottawa preferences were in turn supplemented by special trade arrangements, notably with the Scandinavian countries. Thus, there was built up a closely knit international system composed of ten or a dozen sovereign and, to all intents and purposes, independent nations. This new British international world, the sterling area, while less ambitious in scope, is more homogeneous in its institutional arrangements and therefore more likely to prove workable. With its own monetary system, it is rapidly developing complementary and interdependent channels of trade. It constitutes an integrated world of its own, separated from the general world chaos.

It is quite impossible to view current world international problems realistically without having first of all a clear recognition of the existence, strength and probable continuity of this new entity. Future international developments will be determined mainly by the answer to the question whether this entity will become the focal point from which there may be developed a new and inclusive international system, or whether this new entity will prove the starting point of the development and continuation of a group of preferential systems, each striv-

ing for self-sufficiency and aiming to minimize its contacts and relations with other corresponding areas.

The breakdown of a truly international system and the formation of preferential and more or less separatist areas explain, at least in part, the current explosive international situation. Take the problem of raw materials. Access to essential raw materials has become again a leading source of international friction and conflict. This is so because of the breakdown of the international system. Access to raw materials could not possibly be a matter of concern to any country so long as we had a well-functioning international structure. The raw-material-producing countries cannot be charged, except in the rare case, with monopolistic restriction of output or with an arbitrary, selfish or nationalistic appropriation of natural resources. In general they are eager to sell their product in the world market, frequently even at ruinously low prices. The difficulty does not come from this side. The difficulty arises from a breakdown of the world currency and from inequality of treatment in commercial policy. A shattered, disorganized world does not afford ready pathways or easy access to the raw materials needed by modern civilization.

In a recent pamphlet Sir Norman Angell says that it is of course open to Germany to get wheat and wool on exactly the same terms as a Britisher gets them.

> The Britisher cannot get them without paying for them, and if the German could manage to change places politically with the Britisher, the former would still have to pay. And the point is that he would have to pay just the same price at which he could obtain the wheat without having to conquer the country at all. The change of political situation would not alter the fundamental economic situation in the least. . . . Argentine, Brazil, and Australia supplied Germany with food and raw materials in exchange for manufactured goods quite irrespective of the fact that they are not German colonies, nor part of a German empire. Australia supplied Germany with wool on exactly the same terms as it supplied Britain.[1]

All this is certainly not true. In this argument Sir Norman overlooks altogether the all-important fact that a country cannot buy unless it has the means of payment. In order to buy, you must also be able to sell. Thus political boundaries, in-

[1] *Raw Materials, Population Pressure and War*, p. 21.

volving preferential tariffs or other preferential trade treatment, become of immense importance. Germans can certainly not obtain wool from Australia on equal terms with Britishers for the reason that Germans cannot sell in Australia on equal terms with the British. Sir Norman's argument *would* be thoroughly sound in a genuinely international world, but it is utterly fallacious in the kind of world that, in recent years, is being built up all about us. At one point, indeed, it appears that he is just about to state the case correctly. He says, " Our problem is not to overcome any difficulty of access to raw materials arising from the refusal of the foreign producer to sell them; it is to find the means of paying for them ", and then instead of going on to point out that the means of payment is seriously interfered with by the erection of preferential areas, he says, instead, that this problem is not going to be solved by the rearrangement of frontiers. With this latter statement, I should, of course, not quarrel, but the really important thing is left unsaid.

The truth is that very many countries in the world today find access to raw materials well-nigh blocked, not because they cannot buy but because they cannot sell on terms of substantial equality. You cannot buy raw materials unless you can pay for them, and you cannot pay for them unless you can sell goods in exchange. Thus, of necessity, an effort is made to offset the development of preferential areas, by similar or equally effective methods. One preferential area breeds another. As in the case of so many human problems, one rapidly becomes enmeshed in a vicious circle. The world factors which have accounted for the formation of the British preferential area can, of course, be readily understood. But it is also not difficult to see that this action has stimulated unfortunate developments elsewhere.

We in the United States are in no position to cast bricks at the British imperial preference system. The British Empire has as much right to its preferential tariff system as we have to our high tariff policy, or at any rate to our preferential arrangements with Cuba and the probable impending preferential arrangements with the Philippine Islands following complete independence. Indeed, viewed realistically from the strictly economic standpoint, our American tariff system amounts to a

preferential arrangement between more or less sovereign states. Moreover, the adamant tariff position taken by this country in the decade of the twenties played, as every one knows, an important rôle in the events which led to the general world breakdown.

England's abandonment of the gold standard was, as one can by now fully appreciate, a bomb loaded with enough dynamite utterly to shatter the international price and monetary structure. This concussion in turn set off fresh explosions, of which the chief was the depreciation of the dollar and the re-linking of it to gold at an undervalued rate. After such shocks, the world will not soon recover its equilibrium.

The impact of sterling and dollar depreciation upon the commercial policies of Continental Europe is well known. Preferential quotas and clearing arrangements, which in effect work to establish preferential markets—these are the answers of Continental Europe to the erection of the sterling area, the imperial preference system established at Ottawa, and dollar depreciation. Germany's network of clearing arrangements amounts to a highly artificial and complicated set-up of preferential markets designed at whatever cost to feed Germany's great industrial machine with raw materials. The leaders of her commercial policy, indeed, insist that without this mechanism her access to raw materials would have been virtually closed. Whether or not this is true, it is at any rate clear that these preferential arrangements have violently shifted the established currents of world trade. Countries which through long decades have been the major sources of important world raw materials are now confronted with sharply reduced markets. In the face of accumulated stocks and ruinously low prices in the established raw-material-supplying countries, other parts of the world are rapidly producing substitute supplies. This could not have happened in an organized international world. It is, however, a brutal fact today. There could be no more conclusive demonstration of the grave error of assuming that access to raw materials presents currently no serious problem.

In France, and in the other remaining gold countries, quota allotments have served as the leading instrument by which preferential arrangements have been built up. In Italy the

trend has progressively been toward a close regimentation of foreign trade more or less comparable to the German system involving exchange and clearing controls. Thus on the continent of Europe generally there no longer exists in any real sense a price system so far as international trade is concerned.

What is the situation in other parts of the world? In the huge Russian Empire there prevails a complete government monopoly of foreign trade. Obviously the price system in international trade is non-existent for this large area. If we turn to the Orient we observe the increasing penetration of Japan into China. Larger and larger areas are coming definitely within the sphere of influence of the Japanese Empire. Moreover, the announcement and determined prosecution of the "Japanese Monroe Doctrine" point toward the weakening, if indeed not the complete disappearance of the Open Door policy in the Far East. Thus there appears to be in process of development an Oriental preferential area under the hegemony of Japan.

As one surveys the general world picture, one cannot fail to be impressed with the fact that in place of a general international system, there have already been created a number of preferential areas with the tendency toward a minimization of commercial relations between each of these groupings. One can divide these preferential areas into two main classes. On the one side, there are those which have been created and are functioning by means of rigorous regimentation and direct government control in the form of clearing regulations, fixed quantitative restrictions or outright governmental monopoly. In all these types the price system no longer functions so far as international trade is concerned. In the second main category are those preferential areas, such as the British system, in which the price system does continue to function.

In view of the present deplorable state of economic international relations, what may be done to rebuild a genuinely organized economic world? The beginning will have to be made in those areas in which the price system is still functioning, namely, the sterling area and the United States. The British sterling area and the United States are not only in the freest position to re-direct the world back to an international system, but they also have a major responsibility, because of

the impact of their past policies, to insure for other countries reasonable access to the rich raw materials contained within their boundaries. Only by establishing again a workable international system can nations be made to feel secure in their access to needed raw materials.

Desperate conditions call for bold action. I am well aware that such action is difficult in international relations. Too often timid action alone appears to be practicable. The proposal which I am about to make may perhaps be regarded as visionary. I do not think so, and at any rate it is something which ought to be done whether so-called practical politics can find a way to do it or not. An example of what *can* be done under very difficult conditions is the trade agreements program so persistently carried forward by Secretary Hull. Twelve bilateral agreements have been completed in less than two years, a really remarkable achievement, when one considers the obstacles in the way. Thus far no agreement has been made with England, and in view of American-Dominion competition in the British market, a bilateral agreement will not be easy to execute. In these circumstances, a broader attack might not inconceivably prove more practical. I have in mind a broad multilateral agreement between the United States and the whole British Empire, the Scandinavian countries, and all those countries with which bilateral trade agreements have already been signed.

All these countries are operating, with few exceptions, so far as their foreign trade is concerned, under a price system. Together they could now take an important forward step leading toward the eventual development of a general international system. This would need to take the form not only of commercial arrangements but also of monetary stabilization. Such a convention would have to be drawn in terms which on the one side would establish no new preferences from which the rest of the world was excluded, and which on the other side, would give a definite incentive to all countries of the world to join.

With respect to commercial policy such a multilateral convention might take the form of a commitment on the part of each country to reduce the tariff ten per cent each year for a period of three years on those commodities of which 75% of

the total imports come from the combined countries joining the convention. These reduced rates would, however, be made available to all countries with which the contracting parties now have *de facto* most-favored-nation relations. This plan amounts in fact to the application of the principle of the leading supplier, which has already been made the guiding rule in the bilateral agreements concluded by this country. Such an arrangement would enable the contracting parties to reduce the tariffs chiefly to the advantage of each other without resorting to discrimination, with respect to the commodities in question, against non-contracting countries. At the same time, it would give a powerful incentive to non-contracting countries to join the multilateral agreement in order that tariff reductions might also be made on those commodities for which they are the leading suppliers.

An important part of such a multilateral agreement would be, if not a *de jure,* at any rate an experimental *de facto* stabilization of the dollar-sterling exchange rate. This should be accompanied by the invitation to other countries to join such an international stabilization agreement at rates to be established within such limits as could be more or less objectively determined by considerations of international cost-price equilibria.

A general forward movement by the United States, the British Empire, the Scandinavian countries and those countries which have thus far made bilateral pacts with the United States toward the reëstablishment of an integrated international system covering such a large part of the world would become a powerful magnet attracting other nations to its orbit and gradually leading to the breakdown of the isolated preferential areas which are now being fastened and are in danger of becoming fixed, frozen entities within the world economy.

These countries alone can lead the way in such a movement. They have the advantage of undervalued, or at least not overvalued, currencies behind which they can well afford a program of tariff reduction. Moreover, in the interest of world peace and indeed of their own fundamental prosperity, they must make available freer access to those raw materials with which they are so abundantly endowed. The solution cannot be any rearrangement of political boundaries or the wholesale transfer

of colonies, but rather an organized and workable international system. This involves the reconstruction of an international monetary standard and sufficient leveling down of tariffs and other trade barriers so that countries can pay for the raw materials by means of exports. The markets of this great area must be made reasonably free and accessible to all nations. We cannot face reality without accepting these economic necessities.

The conclusion is that we must do our part to make it possible for the world to put aside all solutions of access to markets and raw materials which run in terms of the erection of preferential areas.

Fortunately under the able leadership of Secretary Hull, the United States has taken a firm and unflinching stand in keeping alive the most-favored-nation policy in a world which is being swept rapidly toward the preferential system. Had this country also embarked upon preferential arrangements, the outlook for the reconstruction of an international world would be far blacker even than is the case. The United States can, moreover, make its contribution by continuing, as a permanent measure, the program of trade agreements, and by making this the vehicle toward a progressive reduction in trade barriers. Finally the cause of world peace and security would be immensely strengthened if in 1937 Great Britain should be able to modify her imperial preferential structure in the direction of a more international system, instead of strengthening the tendency toward a closed imperial economy. Preferential arrangements create their counterpart elsewhere and they sound the death knell of the international system. Equality of treatment in commercial policy is essential to meet the problem of access to raw materials and to minimize the international frictions arising out of the unequal distribution of natural resources.

Remarks by the Chairman

Mr. Adolph C. Miller: Our program is marching on. We are getting near the firing line.

The next subject is "The Place of Gold in the Monetary Standards of the Future". This subject is to be presented by Professor Frank D. Graham of Princeton University, whom I now have the pleasure of presenting to you. Professor Graham!

THE PLACE OF GOLD IN THE MONETARY STANDARDS OF THE FUTURE

FRANK D. GRAHAM
Professor of Economics, Princeton University

AN aura of uncertainty surrounds present monetary units and shrouds their future in obscurity. This atmosphere evokes in conservative breasts a yearning for the good old days when the gold value of all the significant currencies was, in a mildly restless world, a fixed point of reference to which the prudent might repair. Be it ever so defective the international gold standard has, to the cautious soul, all the attractiveness of home, sweet home.

It is not at all improbable, however, that, if we should find that home again, it would seem by no means as comfortable as it looks now that we are wandering in the wilderness. New worlds are never discovered by turning back. They have their dangers, no doubt, but they may also be flowing with milk and honey. Even the old world is no longer what it was and institutions which were appropriate to the conditions of yesterday may now be deleterious. It behooves us, therefore, not to flee from the unknown into tradition but to scout out the land into which we are moving and to take rational dispositions according to our findings.

No one can know, of course, what the future will bring forth but I do not look for a sustained restoration of the monetary conditions of 1913 or even of 1928. The British, and particularly the Scandinavians, are already exploring new monetary territory and are finding it good. There will be stiff opposition in those countries to the return to a fixed weight of gold as the basis of the monetary unit. I would not presume to guess whether or not this opposition will be immediately successful but I am convinced that the sands of time are running in its favor and that, later if not now, it will prevail.

The heyday of the international gold standard is over. That standard no longer commands anything like universal allegiance in either academic or business circles but is, on the contrary, subject to acrid and cogent criticism. Like other forms of religion it has ceased to be taken on faith. The change of atmosphere in recent years is astounding. Twenty-five years ago almost no responsible person doubted that the maintenance of the gold standard was the sole goal of monetary policy. The economic structure was therefore forced, at whatever cost, to adapt itself to the errant course of gold. Today we are acutely conscious of the fact that our monetary arrangements have not been good; we are not disposed to forget the end for the means; and we are bent upon making money serve rather than dominate our economic life. The advocates of the traditional type of gold standard are in consequence on the defensive. The defenders of the faith still retain the respect of the economically pious but they must meet the challenge of a growing and belligerent group of skeptics who are likely to force the orthodox at least to compromise with their convictions.

All Western monetary standards have for a century or more been managed but they have been managed for quite different ends from those which are now coming into prominence. The question is not whether we shall have management but what the objectives of that management shall be. The traditional objective was merely to keep all forms of currency of unchanging value relative to gold. The developing objective is much broader and seeks to keep the national economy on an even keel at a high level of productivity.

These objectives are by no means congruent; they may even be contradictory. Whatever ultimate success may attend the idea and practice of modern monetary management, we can feel certain that the idea will not be stilled. On the contrary the older form of monetary management will surely be forced to yield to the new and, where they conflict, the old must disappear.

The fundamental objection to the international gold standard, as we have had it in the past, is that it involves the surrender of national independence in monetary matters and, in the absence of international government, of the type of management essential to economic stability.

It is true that any country in more or less permanent possession of a great part of the world's monetary gold might play the game both ways. It is in a position, within fairly wide limits, to determine the purchasing power of the metal. It may sterilize much of its gold or permit it to fructify in the price structure. Such a country might, therefore, pick a given weight of gold as its monetary unit, and strive, perhaps with success, to give it any desired value. Any other nation with a large gold supply, however, might well frustrate its efforts while nations without much gold could hardly be expected to show marked enthusiasm for a standard which would reduce them to the position of satellites or vassals.

During the period 1925-1931, the British had the experience of being tied alternately to the French and American gold standard kites and it impressed them very unfavorably. They are now masters of their monetary fate. They can do what they will with the pound in their domestic economy; they can keep its exchange value against gold currencies substantially stable for as long as it suits them to do so; and they can alter it when they please. Even as regards the possession of gold they are now in a much more favorable position than in the years prior to the abandonment of that metal as a standard. This may perhaps lead them to return to gold but, for reasons already given and to be presently adduced, even the immediate probability seems to me to be as strong in the opposite direction and the ultimate probability very much stronger.

Not only does the traditional international gold standard preclude the beneficial management of currency in the modern sense of the word but it is not even neutral in effect. Some immediate disruption follows any tendency for national price levels to deviate from one another, when there is no possibility of an exchange adjustment, and the price level reconstruction which is forced on one or many nations is a painful and often pernicious process.

The gold or any metallic standard is, of course, a safeguard against extreme inflation. But against a perhaps still more devastating deflation it is so far from being effective as to be suspect as a fairly persistent cause. Not only does the gold supply recurringly run short of the amount necessary to prevent a general decline in gold prices but, even where the total

supply is adequate, all countries under the international gold standard are at the mercy of that one of them which, for any good or bad reason, desires to reduce its price level. The accompanying general deflation, with widespread unemployment and other distress, is a situation which will not be permanently tolerated by countries not too heavily encrusted with the cake of custom.

Deflation in a gold standard world is peculiarly disruptive of international economic relations. A very large part of international trade is associated with unilateral transfers on financial account. These are fixed in monetary terms while commodity prices are not. When the volume of financial obligations is large, the value of commodities sold at low gold prices, following an appreciation in the value of gold, becomes incapable of supporting the debt. National bankruptcy of the debtor countries, vis-à-vis the outside world, is then inevitable and this, of course, adds to the buffeting which creditor as well as debtor countries are then undergoing. The British ran into this difficulty after 1929 and salvaged a sizable part of their international investments only by alleviating the burden on the debtor through reduction in the gold value of the pound; but *we* were a little late and, in consequence, less successful. It is not too much to say that, if a rise in the value of gold should prove either large, frequent or persistent, international finance on a gold basis is impossible.

We should also remember that both the international gold standard and international finance on any substantial scale were developed synchronously in the century between the Napoleonic and the World Wars. The fear of a universal conflict was then at a minimum. In the present state of world trepidation, however, the flight to gold, wherever it is obtainable at a fixed price in a given currency, is from time to time so precipitate as to make the widespread maintenance of gold currencies impracticable even if a reasonable stability in the commodity value of gold could be attained. Fear so increases the demand for gold as to make any practicable supply insufficient.

It seems to me probable, therefore, that the monetary standards of the future will not be such as to provide for the universal acquisition and disposal of gold, or gold exchange, at a fixed price in the several currencies. There will be some such

standards but a dual system of currencies would seem to be forecast. There seems to be no more reason to fear deliberate and extreme inflation in inconvertible paper-using countries with a sound financial sense than there is to fear the abandonment of gold by gold standard countries.

This leads us to the problem of exchange. When we say that exchange stabilization is urgently required, a great deal depends upon what we mean by stabilization. A mere reëstablishment of fixed rates of exchange between the several currencies would be of little consequence. Indeed, so far as the important currencies are concerned, we have had substantially this situation for many months without any general feeling of satisfaction. Unchanging exchange rates are one of the least important forms of stability and, as has already been shown, may give rise to more, and deeper, problems than they solve. The major difficulty now is that, at existing rates of exchange, national price levels are ill-adjusted to one another. To fix the present exchange rates would aggravate the trouble. What we really need, internationally, is a persistently accurate exchange-rate reflection of the relative domestic purchasing powers of the various currencies. This can be achieved much more smoothly with variable than with fixed rates. Exchange rates which moved in the appropriate direction, in proportion to shifts in price level relationships, would be a mollifying rather than a disruptive influence on the currents of international trade. This would bring real stabilization into international trading relationships and would permit the several countries to pursue independent domestic monetary policies without repercussions on the outside world.

Mere uncertainty with respect to exchange rates is not necessarily pernicious. The probability of frequent small fluctuations, or of even a sizable orderly alteration, is not an important disturbing factor in international trade. An active futures market will remove risk from those who do not hanker for it and an alert, but conservative, business man will be subject to no inconvenience in international transactions. It is a certain, rather than an uncertain, change, coupled with uncertainty as to its timing, which is devastating. If France should now definitely announce that the franc was to be devalued by a specific amount at some unspecified date the foreign

trade and finance in which France was involved would be thrown into chaos. No futures market would function. Even without a definite announcement, the general acceptance of the idea that devaluation is inevitable is a crippling factor. The present disruptive force in the exchange markets is not the instability of paper currencies but the fear that the members of the gold bloc will not be able to maintain the gold value of the currency units which they are essaying to hold at a level unwarranted by the underlying fundamental factors.

Wild movements in exchange rates, involving a great spread between the internal and external purchasing power of a currency, are of course an evil—but we should not draw the inference that all movements are to be avoided. If an international agreement could be reached on appropriate rates for the present, coupled with an undertaking by each of the signatory nations that no substantial change would be made except in response, and in proportion, to prior changes in relative national price levels or after a steady drain of gold, we should have all the stability which is either feasible or desirable.

The zone of permissible fluctuations, regardless of shifts in relative price levels and therefore of current norms of exchange, should, however, be considerably wider than the present spread between the gold points of gold standard currencies. It is ridiculous to be shuttling gold back and forth across the ocean in response to such slight stimuli as are now effective. The only gainers from this operation are the shipping companies and the bankers. It has no sound economic function. On the contrary, it ministers to, and exaggerates, any tendency to panic. It has been said that nothing is so timid as a million dollars and it would be very desirable to give them a little courage by making flight, and repatriation, more expensive. This would be useful with gold as well as with paper currencies and would be accomplished by creating, or somewhat widening, a spread between the official buying and selling price of gold.

Most seasonal and other temporary maladjustments could be remedied, without gold movements, if exchange rates were given somewhat more flexibility than has in the past prevailed between gold units.

Long-run adjustments, consequent upon an apparently definitive shift in relative price levels, would be effected by an alteration of the norm rate of exchange, as between independent currencies and gold, and by dragging price levels back into line in the traditional manner, as between those countries which adhered to a fixed-weight-of-gold monetary unit.

The place of gold in such a dual system of international currencies would be to take care of what we might call intermediate-run adjustments—to act as a stabilizer rather than as a preserver of a destructive rigidity in exchange rates and as an auxiliary rather than an arbiter of price levels. Its functions are clearly foreshadowed in the present stabilization funds. Gold would provide a means of payment—at either a fixed or a slowly variable price in the currency of the several countries—adequate to prevent great deviations of exchange rates from purchasing power norms. The supreme virtue of gold in this respect is that it would everywhere find a ready market in unlimited quantities, without prior search for a buyer, and subject to no tariff or other restrictions on movement. The stabilization funds, themselves, would always furnish bids and offers and gold would thus always be available as a makeweight in the international balance of payments. For the most part it would lie unused but this is, in some ways, a virtue. A desired but, for most purposes, a useless commodity is the one type of article for which demand is likely to show the steady elasticity essential to the purpose in hand.

If we succeed in achieving any semblance of an ordered world, moreover, it would be clearly advantageous to have the various central banks keep a sizable part of their gold stocks as special deposits in the Bank for International Settlements and transfer title rather than actually move the metal.

The stabilization funds would absorb the whole stock of gold in the financial system though a private free gold market might well be permitted. The operations of the funds, however, would dominate the market. As an independent currency tended to depreciate in terms of gold the stabilization fund in that unit would buy the currency at a slowly declining gold price and when the currency tended to appreciate, it would sell the currency at a slowly rising gold price, until the limits of the zone of permissible fluctuation were reached. These opera-

tions themselves would set up corrective tendencies, which would ordinarily stop the movement within the permitted temporary limits, and they would be clearly profitable to the fund. By the same token purely speculative, as opposed to hedging, transactions would show a bias toward loss, a matter for congratulation.

When either of the zone limits was reached, and the stabilization fund was persistently called upon to buy or sell at that level, this would be practically conclusive evidence of the necessity for a change in rate in the case of an independent currency and of price level in the case of a gold currency. Such changes would contribute to international trade stability and international agreement upon them ought not to prove difficult. To preclude undesirable speculation, no definitive change of the norm rate, at any one time, should be of greater magnitude than the zone of permitted temporary fluctuation.

A system of the character above outlined, which in its incipient stages is perhaps developing under our eyes, would give freedom to the several participants to follow whatever domestic monetary policy they might choose, without any disturbance to their neighbors. It combines the virtues of gold with those of free currency standards and would use the sacred repute of gold to foster, rather than to thwart, economic endeavor.

But, it may be asked, what shall we do about long-term international finance? The danger of undertaking international obligations in terms of gold has been impressed upon borrowers in recent years but the course of financial history goes to show that both borrowers and lenders learn but little from the past. We may therefore expect some new international investment in gold as the only medium likely to prove mutually satisfactory to some of the prospective parties. This may produce some awkward situations as between the gold standard countries and those with independent currency units wherever such countries are on opposite sides of a long-term financial transaction.

We should not forget, however, that the gold standard itself achieved international standing largely because it was the currency of Great Britain, which was the great international lender. In other words it was sterling, rather than gold as such, which became the international unit. After a period of

partial eclipse, sterling, despite the severance of the tie with gold, seems well on the way toward resumption of its former dominance. If something like the present currency standard is retained in Great Britain, therefore, it is likely to be retained in many other countries. The tendency to tie to sterling rather than to gold is even now prevalent.

There is no reason to believe that borrowers will be reluctant to contract in sterling of unfixed gold value. Theoretically, this would subject them to possible exploitation by the British monetary authorities, who might raise against them the commodity value of the pound. In practice, however, it is well-nigh certain that sterling, if it remains untied to gold, either will be held substantially stable in commodity value or will depreciate. Borrowers in sterling, rather than in gold, would therefore have everything to gain and nothing to lose, unless we make the rather unlikely assumption that gold will steadily depreciate both in commodity and in sterling value.

It seems probable that sterling international loans will, under these circumstances, become increasingly desirable to borrowers, relative to loans in gold, and that gold standard lenders may be forced to adjust themselves to this situation. One possibility would be a division of the international investment field on sterling area vs. gold bloc lines with borrowing and lending transactions going on within each group but not between them.

If sterling shows substantial stability of value and gold does not, however, it is perhaps not fantastic to expect that a considerable volume of the international lending of gold standard countries will eventually call for variable gold payments, measured by some recognized, impartially determined, index number of the gold prices of international commodities.

The League of Nations might well begin the construction of such an index number. Since the bulk of the debtor countries are exporters of foodstuffs or raw materials, and foodstuffs and raw materials are the only goods which move at all freely in international trade, the index number might well be confined to such goods, which have the additional advantage of being standardized.

International indebtedness contracted along these lines would be automatically adjusted to the fluctuating ability to pay of the debtor countries, would be fair to both debtors and creditors,

would greatly reduce the tendency toward collapse in the mechanism of international finance, and would tend to preserve stability of payments in stable value currencies.

Such loans would readily be accepted as desirable by economists but they will seem strange to the financial world. They would certainly not develop except in response to pressure but that pressure may well appear sooner than most of us now expect.

It may be that here, and elsewhere, I have entirely misgauged the trend of the times and that in letting my imagination run I have let it run riot. I offer these remarks not as predictions, but merely as guesses at the trend of things, which only by accident, of course, follows the dreams of economists of any school of thought. Yet the present prejudice against paper currencies will, in all likelihood, disappear as soon as it becomes apparent that they can be superior standards of value, linked to a composite of goods rather than to a single commodity and that they need not be the purely arbitrary units — no *standards* at all—that they have always been in the past. The world will then readily accept a theory, elucidated by the course of events, which it could never understand so long as it remained a mere closet philosophy.

Remarks by the Chairman

Mr. Adolph C. Miller: It is the nature of human society, as it is that of individuals, to learn through crisis. The child, if its parents have been wisely selected, does not repeat the same mistake too often.

These papers have well brought out what you already know, that the world today is in a profound crisis. The danger, of course, in such circumstances is that we try to learn too much from the crisis and, therefore, indulge in that most agreeable of all pastimes, to make the world over.

It is well to remember the old maxim, "Make haste slowly", and particularly the maxim of Mark Twain, "Don't get out of an experience more than there is in it." (Laughter) "The trouble", he said, "with the cat that sat on the hot stove was that forever afterward he was afraid to sit even on a cold stove."

Because I believe that the way to monetary restoration and certainty leads back to gold, I propose: 1. to review briefly the gold standard as it was developed in the nineteenth century; 2. to comment upon its premature reëstablishment during the years 1925 to 1928; and 3. to offer some suggestions on the problem of the return to gold in the future. (Mr. Miller then read his address entitled "Whence and Whither in the Gold Standard?", *cf. infra,* pp. 83-92 —Ed.

WHENCE AND WHITHER IN THE GOLD STANDARD?

ADOLPH C. MILLER

Member of the Federal Reserve Board, 1914-1936

I. The Gold Standard in the Nineteenth Century

THE opening of the twentieth century had witnessed the all but universal adoption of the gold standard by the nations of the world. It was in a fair way of becoming one of the established institutions of the modern world. The word " institution " is used advisedly. The gold standard is imperfectly understood, if it is regarded merely as a piece of monetary mechanism. It is that, but it is also very much more. The countries that were tied together in the gold standard system represented to a not inconsiderable degree a community of interest in and of responsibility for the maintenance of economic and financial stability throughout the world. The gold standard was the one outstanding symbol of unity and economic solidarity which the nineteenth-century world had developed. Implemented as it was by the central banking organizations which had grown up in most of the gold standard countries, any disturbance of an economic or financial character originating at any point in the world which might threaten the continued maintenance of economic equilibrium was quickly detected by the sensitive foreign exchanges. The processes of checking the threatened upset were set in motion and usually worked with such quickness and smoothness that only those whose business it was to keep in close touch with what was going on in the world of finance and commerce knew that anything had threatened. In this way, the gold standard system became in a very real sense a régime or rule of economic health, a method of catching economic disturbances in the bud and preventing the accumulation of stresses, strains and maladjustments in the economic structure which, if unchecked, would grow to catastrophic dimensions.

It is a mistake, and a serious mistake, to think of the historic gold standard as a system whose one and only objective was the maintenance of the convertibility of a country's currency and the stability of its foreign exchanges. It was in its larger significance a method—the most effective that the world has yet known — for promoting and cultivating conditions conducive to the development and maintenance of a well-compacted and stable economic and financial order.

It should, however, be noted, and particularly by those who are today proponents of an early return to the traditional gold standard, that conditions in the nineteenth century were on the whole exceptionally favorable to the efficient operation of the gold standard. Anyone who is well acquainted with the nature of the gold standard knows that it is not suited to all climes and conditions. It is, in a way, an aristocrat, and must be surrounded by satisfactory conditions. Of itself it cannot create those conditions, nor can it restore them when they have become badly deranged. Its business is the maintenance of good conditions when they already exist rather than their restoration when they have become bad.

The gold standard, it may not be overlooked, originated and developed under economic conditions which were highly competitive, and it functions best in such conditions. Such was the economic society which existed prior to the World War. In an economic world in which competition is the shaping influence and ruling force, the economic structure is flexible, things tend to find their level and industrial readjustments made necessary by monetary or other changes take place without long delays and painful dislocations. Under such conditions external prices and internal prices are kept in close adjustment with one another: so also are internal prices and costs—that is, wages and other forms of income; and thus, in the language of the economists, the price-cost structures of the different countries are kept in proper relationship with one another and purchasing power parities of the currencies of the different countries maintained. Such conditions are favorable both to the achievement and to the maintenance of economic balance and therefore to the efficient operation of the gold standard. It should be emphasized that it does not work as satisfactorily in a society whose economic structure is losing

flexibility—the problem of achieving and maintaining balance then becomes a much more difficult one, and so does the business of successfully operating the gold standard.

It is considerations of this character which make the question of the return to the gold standard in the world of today and under the conditions of today a problem which is far from being as easy of solution as too many of those who are impatient for its immediate or quick return assume.

The problem of monetary restoration confronting our country and the whole world today is at best a difficult one, and one not to be approached lightly or in a mood of merely sentimental attachment to ancient loyalities and moralities. The problem calls for the exercise of sustained objectivity, severe realism, and the patience and tolerance which proceed from understanding.

The mistake of premature restoration of the gold standard which was made ten years ago must not be repeated. Its consequences not only would be disastrous to the future of the gold standard, but might easily prove a tragic economic disaster for the whole world.

Such were in the high period of its historic renown in the nineteenth century the nature and working of the gold standard, at any rate in its larger and more significant lineaments. Let us now inquire how it fared when the attempt was made after the war to restore it.

II. The Restoration of the Gold Standard in the Years 1925 to 1928 and Its Breakdown

During the years 1925 to 1928, under the leadership of Great Britain, most of the countries of Europe and many in the overseas world undertook to hasten the economic and financial reconstruction made necessary by war by restoring the gold standard. Country after country, aided by Great Britain and the United States, reëstablished its currency system on a gold basis, each acting more or less independently of the others and without much regard to the effect that its action would have upon others in fixing the gold content of its monetary unit, and apparently without any serious inquiry as to whether conditions of economic equilibrium in the world had been restored to the degree necessary for any enlightened decision as to the

relative values of the different national currencies which were to be defined in gold.

Events soon proved that the world was not yet ready for the restoration of the gold standard. It was with difficulty and only with the liberal assistance of the United States that the newly restored gold currencies of Europe and elsewhere were able to maintain themselves. The much-complained-of maldistribution of gold, the excessive amount of the world's financial funds held in the form of short-term and migratory money seeking a hide-out first in one country then in another, to the embarrassment no less of the country in which it took refuge than of the country it had forsaken, may be cited to show how seriously out of joint the world still was. The world was too disorganized, on both the economic and the financial side, to provide the conditions essential for the satisfactory operation of the gold standard. The history of these and the subsequent years of deep depression and distress which has not yet ended shows convincingly that the world had not yet recovered its economic balance, had not yet become a world suited to the regimen of the gold standard—in a word had not yet again become a gold standard world.

Monetary systems almost universally were still managed. In meeting the succession of economic strains and financial difficulties which were encountered even before the crisis of 1929 the old gold standard simply could not, and therefore did not, operate. It had to be managed, and managed mainly to keep itself from breaking down in many countries where from the beginning it at best enjoyed only a precarious position. The economic consequences which followed from this hybrid monetary régime are a matter of too recent history to require more than passing reference. It may be well to recall, however, that the train of antecedents dating back in the United States to the year 1924, particularly our great adventure in 1927 in helping to keep the weakened gold standard in Europe from falling, which finally culminated in the economic and financial catastrophe of 1929 with its legacy of tragic consequences, is not to be charged to the gold standard, but rather to the way in which that standard was perverted and managed. During the whole of this critical period the practice of the gold standard was more honored in the breach than in the observance, and under

the supposed protection of the gold standard the monetary systems of gold standard countries, almost without exception, were being managed to a degree and in ways utterly foreign to its nature. Events have since conclusively proved that the world had not yet sufficiently recovered to submit its monetary and economic life to the discipline of the gold standard and by force of similar circumstances throughout the whole post-war period there has been a managed currency basis. The world of today is a managed currency world and will continue so until the healing forces of nature and a large-minded statesmanship are brought to bear on the task of helping the forces which make for economic integration in the world and hindering those which make for further disintegration. The philosophy of the classic gold standard is the philosophy of economic integration. Its goal is a world which is integrated, not only as to each of its component parts, but as to all of these in their relations to one another. Until the world returns to such a position monetary systems will continue to be managed money systems in one degree or another, such as is the case today. The world will be fortunate if these systems are managed with a return to gold as their constant objective.

The mistake made by the premature restoration of the gold standard in Europe and elsewhere after the war was in thinking that monetary restoration through the gold standard could accomplish economic restoration. Events of past history and those of recent history to a poignant degree have shown conclusively that when the economic structures of the world and its leading countries have become badly disorganized and disintegrated and monetary systems demoralized and debauched, economic restoration must precede monetary restoration, or they must at least proceed hand in hand. Such situations require far more flexibility in the monetary mechanism than is consistent with the gold standard. The adjustments and readjustments in the process of helping the recuperative powers of nature require temporizing, compromise and management. Under such conditions, the flexibility of a managed currency system has advantages which the rigid form of the gold standard system does not possess in requisite degree. It would be shortsighted, therefore, to expect that in the present economic state of the world the gold standard system as it was

in the days of its pre-war ascendency could be reëstablished and put into full operation in the near future, if ever again.

Such, in brief, is the tale of the unhappy career of the gold standard in the first attempt at its restoration after the war.

Are we to conclude from this recital that all thought of basing monetary systems of the future on gold must be abandoned? Not in my opinion. On the contrary, I see no reason for expecting or believing that any satisfactory and workable money system which all nations, or, at any rate, all the more important ones, may be expected to adopt and to coöperate to maintain and operate, can be designed unless it is based on gold.

The monetary problem confronting the world today is to work out the conditions—political, economic and technical—under which the return to gold can be accomplished — expeditiously, of course, but also, and chiefly also, safely and usefully.

III. The Return to Gold in the Future

In the return to gold, and particularly in judging when conditions are propitious for the return, the attitude of Great Britain will be most important. It may be well to recall that England was the birthplace of the gold standard. She gave it to the world. She built it up into a universal monetary system through the genius with which it was administered by her from the last third of the nineteenth century to the outbreak of the World War. During that period the gold standard developed into one of the great institutions of the modern world. England was its financial center: all roads led to London. The pound sterling became the universal unit of international settlement. The Bank of England, through its farsighted and skilful management, made the gold standard the balance wheel of stability and the symbol of international financial order and certainty. With the outbreak of the war, to repeat what has already been said, the gold standard broke down. Great Britain led the way back to its restoration in 1925. Later events proved its reëstablishment to have been ill-advised at that time. It led a precarious existence. After a desperate struggle, in the year 1931 Great Britain led the way off the gold standard. She suspended gold payment, i.e., the

sale of gold by the Bank of England at a fixed price, and left the value of sterling to the determination of circumstances and the judgment of the monetary authorities to whom she entrusted the management of her money. With such consummate skill have the Bank of England and the British Equalization Fund handled their problem that Great Britain presents to the world today the most striking instance in history of a successful enterprise in exchange and currency management on a large scale and under highly difficult conditions.

The United States suspended gold payments and a free gold market early in 1933, but did not abandon the gold standard except for a short space of time. It was not many months after suspension when the gold dollar was revalued and gold bought and sold at a fixed price of $35 per ounce. Since then the dollar internationally has shown a high degree of stability.

Considerable progress has therefore already been made toward the stabilization of the world's two principal currencies and has brought us appreciably nearer the day when *de facto* stabilization may end and a complete and assured stabilization of the currencies of the world's leading countries be contemplated and prepared for and eventually attained through the return to gold in some form suited to the circumstances of the world today.

The problem is now mainly one of bringing the two great countries of the English-speaking world into an accord in a determination and an endeavor to further monetary stabilization by preparing and testing the ground so that when the moment for restoration will have arrived gold parities, not only for their own currencies but for at least those of all the larger countries, may be ascertained and established, which the course of subsequent events will show to be truly adjusted to economic conditions and circumstances.

These conditions and circumstances, it must be recognized, have changed in many ways, in some ways profoundly, in the almost twenty-two years which have elapsed since the world last witnessed the successful operation of the gold standard. These changes may not be overlooked in devising the ways and means of effectuating a return to gold, nor the safeguards to which they point as suitable and necessary to the successful operation of the gold standard of the future. The economic

and social structures of nearly all countries of the Western World have been losing flexibility since the World War, some of them to a degree that would perhaps better be described by saying they show signs of increasing rigidity. Such has been conspicuously the case in Great Britain, and such is also coming to be the case to no mean extent in the United States.

Monopolies and other forms of capital control, labor-organization control and the multiplying forms of government control, both economic and social, trade barriers, tariff discriminations, import quotas, subsidies and bounties may be cited to indicate the spread of the stiffening process which is creeping over the body economic of our own and many other countries today. These devices, which would have been described by the economists of an older day as interferences with the free play of competition, are symptomatic of far-reaching changes in political, social and economic outlook which the twentieth century has brought. The pressures which the World War and the great depression have exerted have, of course, greatly accelerated and intensified this drift, but it probably would have occurred in any case. The Western World had entered the "Age of Welfare" even before the war, but happenings since then and notably in the last few years have set countries, including our own, far ahead on the new course. The student of monetary science may not overlook the significance of this drift or trend in affecting not only the future of the gold standard but the whole problem of monetary organization and control in the future as well. The gold standard of the future will of necessity have very much less of an automatic, self-regulating character about it than that of the last century, because the economic world in which it will operate will also have very much less of a competitive and self-adjusting character. The operation of the gold standard in an economic society whose joints are stiffening presents a different and much more difficult problem than its operation in the flexible world of the nineteenth-century highly competitive society. As economic structures become more rigid the gold standard itself must become less rigid. It must develop the capacity to adapt and adjust its operation to a degree never in contemplation before the war. The gold standard of the future must lay aside the habits of the aristocrat and cultivate those of the

democrat. It must learn to adapt itself to new surroundings and their requirements and not regard itself as its own end. While continuing to perform, as before, the function of providing the commerce of the world with a common currency of indubitable character, it will also and at the same time have to perform the function of supplying national currencies adjusted to domestic circumstances, in order to meet the reasonable requirements of the economies of the different countries operating under the gold standard system. The application of the gold standard will have to be tempered at times and firmed at others. Implementation and guidance will play a far larger and more important part in the administration of the gold standard of the future than in the past. The central banks in Europe and the Federal Reserve System in the United States will be tied in very closely with that administration. They will perforce operate the gold standard of the future. They will be its guardians, ministers and masters. A high sense of purpose and responsibility, deep understanding, wisdom, skill and statesmanship will be called for from them, and not least in the preliminary trial period when the ground for a return to gold is being made ready and proved. The enterprise and responsibility with which they will be charged will be partly national and partly international, but always directed to a common end and to that extent, at least, a common enterprise. Its end will be the furnishing of the world and the several countries belonging to the gold standard system with a currency and a form of currency control that will do all that may be reasonably expected of the monetary mechanism toward keeping the economic systems of the several countries and the world economy in which they each have a profound stake in a going condition, i.e., as nearly as may be in a state of continuous functioning. Such an enterprise or endeavor must obviously follow the lines of mutual understanding and accommodation. No prescribed formula can be laid down in advance, least of all by any one country for the others.

That the gold standard can be re-created into an institution of both national and international monetary and economic service; that the gold standard of the twentieth century, when it finally takes shape and is given the support both of the peoples and the governments of the world, will again become a

great institution not only of monetary certainty and safety but also of financial order and economic stability, and again give to the world a much-needed spirit of community of interest and responsibility, I do not doubt. That is why I am for the return to gold as the only secure foundation on which to rebuild the monetary systems of the future.

The time has come to end the period of monetary experimentation and hesitation and to begin the work of monetary reconstruction. Our own government has recently spoken: we are ready to proceed. The world now awaits a sign from Great Britain. When she has spoken the way will be open for the rebuilding of the old gold standard system into a twentieth-century institution.

Remarks by the Chairman

Mr. Adolph C. Miller: Professor Angell of Columbia University, a man who needs no commendation to a New York audience, will now lead the discussion. When he has finished, the papers that have been presented here will be open for brief discussion from the floor, but all remarks should be limited to five minutes.

I now have the pleasure of presenting Professor James W. Angell!

CURRENCY MANAGEMENT AND THE GOLD STANDARD: DISCUSSION

JAMES W. ANGELL
Professor of Economics, Columbia University

I SHOULD first of all like to congratulate the Academy of Political Science on its having had the privilege of listening to the preceding speakers, and to congratulate the speakers themselves on their admirable papers. There is no group of experts whom I would so gladly have heard on the intricate and difficult questions at issue this afternoon, and none who are more competent to discuss them.

I have a great deal of sympathy with the general position outlined at the start by Mr. Warren, when he intimated that the root of our monetary troubles lies in the fact that we really don't know what we want to do with the money system. Until quite recent years, and except for certain brief episodes like our silver agitation at the turn of the century, the great bulk of the populations in the Western countries had not realized that the money system was anything more than an end in itself. Sometimes they praised it, sometimes they called it harsh names, but in the main they simply took it for granted. Since the war, however, and particularly since the beginning of the world depression, an ever-increasing number of people have discovered that the money system is not merely an end in itself. They have discovered that it can be made into a tool of vast power, for the accomplishment of far-flung social and political aims, and perhaps even for the transformation of the state itself. The difficulty has been that hardly any two individuals can agree on what these aims should be. There is a money doctor on every street corner, each with a sure-fire prescription; but the prescriptions are all different.

The most fundamental cleavage of opinion, or at least the most urgent one, has developed over the apparent necessity of choosing between internal and external monetary stability.

Yet vastly more time and effort have gone into arguing the relative merits of these two objectives than into finding out what they really mean themselves, or even into finding out whether you really have to choose between them. For example, if we define external stability as meaning adherence to the international gold standard in some form, that is in itself an understandable concept. But the real implications of adherence to the international gold standard, I think, are not fully perceived even today. Several of the preceding speakers have indicated that it probably means you must sacrifice internal stability for external, and must place yourself at the mercy of the accidents of foreign trade, finance and even politics. I agree that past history lends a good deal of support to that view, especially post-war history. But is it impossible to devise an international gold standard which would be free of all or most of these defects? I doubt it. If the leading nations *wish* to set up a decently workable international gold standard, that would not produce intermittent violent distortions within each country—such a gold standard as has never existed for any length of time in the past—I am sure they could. The trouble is that to date they have never really wished to do so.

Then take the other and supposedly opposite objective, internal monetary stability. What does this really mean? Some say stability of prices; others, stability of production, or of employment, or of debt burdens, or of investment, or of money incomes; and others talk still more vaguely about a "general balance" in economic activity. Now something can be said for every one of these possible objectives. But, as Mr. Warren has quite rightly pointed out, you probably cannot have *all* of them at the same time. You must probably choose some one or perhaps two among them, and discard the rest; and with most of them you may also, in practice, have to discard part or all of the international gold standard. All this can be shown fairly easily, by reasoning which I shall not inflict on you here. The practical difficulty is again to decide *which* objective you will choose, and again hardly any two people agree. Some are Communists and some are conservatives; some are isolationists, and others remember William Jennings Bryan.

What it all comes down to, I think, is broadly this. The world today is in the midst of a vast whirlpool of conflicting social, economic and political forces, both national and international. The world's money troubles are in largest part the *result,* not the cause, of these profound and shattering conflicts. Until the conflicts are resolved, or at least are greatly abated, it is unlikely that an international monetary system will evolve which can offer any assurance of continued stability. Some of the conflicts, perhaps, will be settled only by the holocaust of war. Others I hope can be settled by a series of arrangements like those so skilfully outlined by Professors Hansen and Williams, and perhaps still others by a slow process of compromise and patience, giving a little to get a little. Until the nations of the world really want one, however, and will make definite choices and sacrifices, an enduring international monetary system can hardly be created.

But what of our own problem in this country? Do the foregoing remarks mean that we must either let our monetary system drift until the rest of the world will coöperate with us in some fashion—perhaps along Professor Graham's lines—or that we must choose once for all a policy of internal stability, at the price of external stability? I do not believe so. The long-run objective of monetary policy which I personally chance to favor, as some of you know, is substantially the stabilization of average money incomes per head of population. But this *is* only a long-run objective, or at least not an immediately urgent objective, and in our present situation there are various serious practical difficulties in the way of trying to achieve it overnight — even were it theoretically desirable. Moreover, while its accomplishment might save us from *future* severe depressions, it could do little to help haul us the rest of the way out of the *present* depression.

Our chief monetary problems at the present moment are of a different sort. To accomplish our own economic recovery today, I think we need, above almost anything else, two things: first, abolition of the present paralyzing uncertainty about the immediate future of the currency, and especially abolition of arbitrary interference with the money system for political reasons; and second, a rapid end to federal budgetary extravagance and the present process of hidden budgetary inflation.

The quickest and surest path to the first of these goals, and perhaps to the second as well, is an immediate return to an unrestricted international gold standard, at about the present levels. We should return to gold with the full realization that it is only a temporary stop-gap, intended to keep from us a flood of graver evils; and we should do it in the full expectation of passing on as rapidly as possible to a better monetary system. But after watching the violent upheavals and the failures of the government's monetary policies over the last three years, my present feeling is that to meet the monetary and the political dangers of next week and next month, we should return to gold today.

PART III

ECONOMIC RECOVERY AND MONETARY STABILIZATION

INTRODUCTORY REMARKS *

RUSSELL LEFFINGWELL
Of J. P. Morgan & Co., *Presiding*

IT is well to recall that all plans for reconstruction after the war in every nation were based upon monetary stabilization and the return to the gold standard or a gold exchange standard. The first to return to gold after the war was the United States. We lifted the gold embargo in the summer of 1919. The early post-war period of frantic paper money inflation in Germany, Austria and the succession states was followed in the mid-1920s by plans of reconstruction and monetary stabilization for those countries. England, France, Belgium, Italy and Japan returned to gold. Even India took steps in that direction. But monetary stabilization proceeded more rapidly than appeasement. While finance ministers and central bankers, aided by other banks and bankers, formulated plans to facilitate trade and recovery through monetary stabilization, politicians and statesmen and soldiers, and the people of each country, only intensified their nationalism, political and economic.

The politicians and the statesmen and the people of the world were not as much interested in peaceful trade and orderly exchanges as the finance ministers and central bankers and other bankers were.

I suppose it must be said that these banking people and these financial people were ahead of their time. Appeasement had not gone as far as that. Sound currency, stable money, de-

*** Introductory remarks at the Dinner Meeting of the Semi-Annual Meeting (Fifty-sixth Year) of the Academy of Political Science.**

pends upon peace in the world, upon freer trade, and upon budgetary equilibrium; and those great steps that were taken in the period of the 1920s under the leadership of the best thought that the financial world could give—under the leadership of the great central bankers and finance ministers, with the coöperation of private bankers—were based on an assumption that there was to be political and economic peace—an assumption which turned out to be unjustified.

How we in America came to be forced off gold, how necessary and grimly inevitable that action was, how cruel and devastating had been the consequences of monetary deflation, and how life-giving and revitalizing and essential to recovery the policy of insuring low interest rates, I need not repeat.

Sound and stable money is the handmaid of recovery, not the master. If we are to have sound and stable money we must have peace in the world—between nations and within nations. We must have freer trade in the world—between nations and within nations. And we must have budgetary equilibrium.

Budget Balance Defeated by Deflation

As long as unemployment, here at home, continues to be great, and government aid on a vast scale continues to be necessary, and capital issues are largely limited to refunding purposes and government issues, recovery must be conceded to be incomplete. It cannot be necessary to say to so intelligent and chosen an audience as this that there ought not to be any reversion to deflationary policies while recovery is incomplete. The great paradox of government finance is that fiscal and monetary policies must be such as to increase and not reduce the income of the people if the budget is to be balanced. A government cannot balance its budget by increasing the tax rates to be imposed upon declining incomes. No more than can a railroad balance its budget by increasing the rates it charges for transportation against a declining volume of business. Deflationary fiscal and monetary policies reduce incomes and increase the burdens thrown upon the state for relief and public welfare. Thus the state that seeks to balance its budget by deflationary policies defeats its object, burns the candle at both ends, increases its expenditures and reduces its income. If there be any among us inclined to oversimplify the problem, to find a happy solution by simply saying " balance the budget ",

let him bear in mind this paradox. A government cannot balance its budget by edict. It cannot extract blood from a stone nor gain revenues by deflating the national economy.

Danger of Dear Money Policy

Low rates of interest must be maintained by Treasury policy and Federal Reserve policy if there is to be recovery and a balanced budget. Any premature effort to make money dear, in apprehension and in anticipation of an inflation which does not exist, will defeat its own purpose by retarding recovery, increasing unemployment, reducing income and increasing the need of government relief. A private business man may, if unrestrained by motives of kindliness and good will and social obligation, hire and fire as he pleases, raise prices and reduce expenses, curtail his business, or wind it up if it runs at a loss. Government cannot do that. Government is the residuary legatee of all the successes and all the failures of all of us. Government must keep itself going and keep its people going too. Government can balance its budget only by enriching its people, not by impoverishing them.

Relief Necessary

Government must intervene to relieve the sufferings of the people. It is intolerable in the modern world with its elaborate mechanism of trade and finance, its highly industrialized and mechanized economy, that our people should be left to starve or to endure privation almost worse than starvation. It is intolerable that the monetary mechanism evolved for the sole purpose of achieving stability and human welfare should be permitted ever again to run amuck as it did from 1929 to 1933. It is an archaic superstition that money is stable if its value remains fixed in gold only, while prices collapse more or less generally to the point of bankruptcy, as they did in that tragic period. During the last three years government policy put an end to deflation, brought about some measure of recovery, achieved monetary stabilization and provided necessary relief. Let us not be unmindful of the depth of economic despair from which in three years we have emerged, nor the vital necessity of government action along these lines, however critical we may be of the extent and manner in which public expenditures have been made, or of this and that phase of monetary policy.

Dangers Ahead

But while we must be grateful for the immense progress achieved and recognize the validity of the emergency which called for the emergency use of government credit and for emergency monetary policies, we must not close our eyes to the perils ahead.

One reason why America financed her part in the war well was that she had no debt to speak of when the war began, a little more than a billion and a quarter dollars. That debt she increased to nearly 27 billion dollars in less than two years and a half. Thereafter, promptly she began debt reduction and continued it for over a decade. From a peak of nearly 27 billion dollars in August 1919 the debt was reduced to the post-war low point of 16 billion dollars at the end of 1930.

It is partly because the United States government debt had been so greatly reduced in the post-war decade that the government's credit was readily available to meet the emergency of the great depression. What do we have credit for? To use when the need arises. How do we have credit to use then? By not abusing it ever. The great peril which confronts us today as a people is that we may learn to abuse the government credit after the emergency need has passed.

Mounting Public Debt

In a little more than two war years the public debt rose 25 billion dollars. In eleven years it was reduced by 10½ billion dollars. But now for five years and more it has been rising steadily and without intermission, until today it has reached an all time peak of over 30 billion dollars, having almost doubled itself in the period since the depression began.

These figures do not include 4½ billion dollars of debt guaranteed by the United States government incurred since the depression began nor the rapidly mounting debt of the states and municipalities.

I have said that the use of the public credit for relief in the emergency and going off gold to stop the deflation were necessary emergency measures. But these were major operations justified and only justified by the magnitude of the calamity that had befallen the American people. We must not drift into the notion that these emergency powers can be availed of as a habit.

Emergency Measures Not for Everyday Use

The credit of the United States and the resources of the American people are so great that the financial risks involved seem even now, after five years of mounting public debt, quite remote. And the easy money policy, which is still so necessary for economic recovery, gives an artificial facility to public borrowing. But cheap money and a mounting public debt are habit-forming drugs to be used sparingly and in an emergency only. The use of them must be discontinued as promptly as possible or, first, they lose their stimulating effect and, then, become severely depressant. Emergency use of the public debt in a crisis is to be applauded. Its abuse becomes a menace. Once let the impression arise that a government has become addicted to these drugs and its credit goes, and along with it the value of its money. Then inflation sets in. And there is no deflation so complete and devastating as that which comes when government credit is vanishing, and with it the buying power of money. That is another paradox—that the most deflationary thing that can happen to a people is a paper money inflation.

Moral and Political Risks

And what of the moral and political risks? The habit of turning to the public treasury for relief and aid and subsidy is deeply ingrained in the American people. This is not a vice of any man or any party, or any period. From the foundation of the Republic, Congress has been besieged by appeals for grants in aid and subsidies and doles, for tariffs and pensions, for rivers and harbors, for public buildings and public works, for roads and canals, in aid of this and that organized national or local group of voters. The pork barrel and logrolling are not new or even recent discoveries. The deterioration of our public life I attribute in large measure to the irksomeness to the public man of the pressure for placating his constituents by grants and favors from the public purse, if he is to attain, or to retain, public office.

Some of us are all too prone to concern ourselves with the mote in another's eye and ignore the beam in our own. Some are apt to be self-righteous in criticism of a soldiers' bonus or unemployment relief, though we rightly approve necessary aid

to banks and railroads; to complain of paying money to farmers for what they don't grow, and yet be complacent about the infinitely more costly tariff favors habitually showered by Congress upon our manufacturing interests.

Evils to Be Avoided

Today the problem of monetary stabilization and recovery appears to have progressed in this country as far as it can while recovery is so largely dependent upon emergency aid from the government, and restricted by the disastrous effect upon our exports and foreign trade of tariffs, embargoes, quotas, disturbed foreign exchanges, wars and the fear of war. The great peril which confronts the Republic aside from the disturbance of world affairs and the curtailment of world trade, is the threat that the long-established and ever-growing habit of treating Uncle Sam as a sugar daddy will undermine the independence and self-respect of the American people and will corrupt the electorate and their chosen representatives.

The Need of a Civil Service

The growing importance of government in our affairs whether we like it or not gives added importance to the efficiency and incorruptibility of the public servant. Next after corruption of the electorate through grants and favors to special groups and communities, the government of the Republic is imperiled by the failure to establish a first-rate civil service by offering a permanent career to first-rate men. The American is too often a jack-of-all-trades and master of none. We are too prone to think of the public service as an honor or a reward for the individual, too little as an opportunity to serve the public. The American people are entitled to something better in the field of public service than the spoils system or the laboratory system. Public service ought not any longer to be regarded as a reward for political service, for campaign contributions, as a field to teach ignoramuses the public business nor for theorists to experiment in. We do not wish to be guinea pigs for laboratory experiments by freshmen students of government and political science.

The increasing power of government and its enlarged functions call out above everything else for the abolition of the

spoils system and the laboratory system and the substitution of a trained permanent civil service of men immune from political attack, immune from political removal, devoting their lives to the public welfare. The upper levels of the civil service of the United States should be made to appeal to the very best of the graduates of our colleges and law schools and business schools. Our government is political and should be. That is the nature of democratic institutions. The president and his cabinet and one political undersecretary should rule each department. The remaining officers and employees should be permanent civil servants trained to their tasks from the highest to the lowest and honored in accordance with their competence.

Eminent Career Men

Tonight's speakers are both trained men, trained in the public service, and both illustrate the value of experience and devotion to public duty. They are both career men in the truest sense, though neither of them has ever held office or emolument from the government of the United States. They are the perfect type of public servant devoted to quasi-public careers. Such men we should have in the service of the United States as well as of its central bank and of the central bank of central banks.

Graduate of Columbia, and holder of many academic degrees, newspaper reporter, lawyer, lecturer and instructor in political science and public law, enlisted as a private in the United States Army, major judge advocate general, decorated with the distinguished service medal of the United States and with many foreign decorations, associated with the work of the Dawes plan and the Young plan for Germany, President of the Bank for International Settlements created under the latter, Vice President of the First National Bank of New York, I have the honor to introduce Mr. Leon Fraser.

ECONOMIC RECOVERY AND MONETARY STABILIZATION

LEON FRASER

Vice-President, First National Bank of New York

Former President of the Bank for International Settlements

OUR topic this evening is "Economic Recovery and Monetary Stabilization". May I commence with a profession of faith? Economic recovery is making rapid strides in every country of the globe save a few. I believe its full attainment to be impossible without monetary stabilization at home and abroad. I believe that once monetary stabilization is realized in and between the *principal* nations of the earth, a period of pronounced prosperity will forthwith ensue; and I equally believe that, in order to preserve that new prosperity and to avert the recurrence of fresh disaster, the leading nations must work together in the monetary field in an endeavor so to regulate and coördinate their credit policy that undue fluctuations in business activity with the attendant sharp variations in price levels, fluctuations which are attributable to monetary causes, may be steadied and kept in check.

In the brief time I purpose to detain you, permit me to mention the outstanding impediments which obstruct the realization of this desideratum of monetary stabilization; to dwell upon certain progress that has been made in eliminating these impediments; to suggest a possible time of bringing stabilization about; and finally to set forth prerequisites to the maintenance of stability, once restored, with particular reference to the contributions required from the United States, if that permanent end is to be reached.

Let there be no equivoque! By stabilization is meant the re-creation of an international monetary system based on gold—a reformed gold standard—to be sure, improved by the lessons of experience—but fundamentally a currency system anchored to the one basic metal all the world accepts and wants.

It is frequently said with superficial simplicity that the gold standard was the cause of all our recent woes. A closer analysis, also seeking simplicity, would describe the primary cause of the financial breakdown in one word instead of two — the word " debt ". Indebtedness, excessive in every country, either internal, or external, or both, attributable in its origin to the inflationary impulses naturally loosened by the war, left with us, after the inflation receded from its peak, an oppressive burden which was the more visible because it was expressed in a measurement of gold. But it was the weight of the acquired indebtedness, however, and not the scales which measured it, that bore us down. The enemy was inflation rather than the monetary standard, and inflation, in the long run, will wreck any currency system, however constructed—wreck it hereafter, just as in the past. To cope with the consequences of vast inflation and to lighten the burden of the acquired debt, most countries, through duress or choice, have followed the way of revaluing gold in terms of currencies, and many countries are permitting their exchanges to float without definite relinking even to the revalued gold. We shall not delay to examine whether these steps were inevitable. They are accomplished facts.

Let the past lie—our faces are turned toward the future. What will the coming monetary mechanism be? Despite the demonstrated inadequacies in the operation of the gold standard, most of which are susceptible to correction by deliberate action and coöperation, after attentive consideration of that school of thought which would discard the gold standard entirely and embark upon uncharted waters, *preponderant* world opinion agrees with the public pronouncement of the Chancellor of the British Exchequer repeating the affirmation of the entire British Empire gathered at Ottawa and at London, when it was redeclared:

> The ultimate aim of monetary policy should be the restoration of a satisfactory international gold standard. The problem with which the world is faced is to reconcile the stability of exchange rates with a reasonable measure of stability, not merely in the price level of a particular country, but in world prices.

The issue is no longer whether the coming international monetary system shall be based on gold. The inquiry is rather

what betterments are possible to make its operation more satisfactory; and the immediate question is upon what terms and when are the *principal* trading nations likely to be ready to re-attach their currencies to gold? Are we prepared ourselves?

In an address on March 5 last, the Secretary of State recalled the announcement of the Secretary of the Treasury that when the world " is ready to seek foreign exchange stabilization, Washington will not be an obstacle ". Mr. Hull also pointed out that the American dollar has been completely stable in terms of gold for the last two years. He did not say, but it was implicit in his remarks, and it is a fact, that the United States two years ago returned to the international gold standard as the basis of our monetary mechanism in our external relations—that is to say, we have been accepting gold at a fixed price in settlement of dollar balances due us from abroad and, equally important, we have surrendered gold at a fixed price whenever the dollar exchange weakened and reached, as it twice did, the lower gold point in relation to a currency also on the gold standard. It is fashionable to denounce the present Administration for the vagaries of its monetary policy. Certainly, that policy has furnished ample ground for criticism, and even ground for condemnation. Yet an objective enquirer must recognize that after a period of painful trial and harmful error, the authorities have seemingly reached three conclusions, each vital to monetary stabilization at home and abroad. First, they have in fact, but in silence, rejected the proposed elastic dollar and have relinked the dollar to gold instead of to some commodity index. Second, they have been, and are, practicing the gold standard internationally, subject to certain qualifications deemed to be necessary because of the present chaos. Third, as the logical next step, they stand ready to participate with other countries in the restoration of foreign exchange stabilization—" Washington will not be an obstacle ". Excellent—but a more affirmative stand will become necessary, a more explicit recognition of the responsibilities which the advocacy of stabilization implies, and some assurance of a readiness to discharge these responsibilities in order to help maintain the reëstablished order. The international standard cannot be left to itself in the vain hope that it will work automatically. Its successful functioning hereafter, particularly

as regards endeavoring to obtain reasonable stability in the price level through credit control, requires deliberate direction and continuous coöperation between monetary authorities of the principal countries, especially our own.

If Washington now has the will to stabilize, where then is the prime obstacle? With apologies to our London guests,* Sir Arthur Salter and Sir Alfred Zimmern, I venture to suggest that today it is Great Britain. In 1933 *we* were the obstacle. Many of the measures taken by us at that time, and since, have contributed to the British procrastination. But that procrastination is not mere perversity. Behind it lie the reasons which reveal the whole subject of stabilization to be so complexly difficult. Many of the reasons have been officially stated; others publicly discussed. An examination of them is illuminating — first, because it is encouraging to note that some progress has been made in overcoming the declared impediments; and second, because the truth is that, inasmuch as no one intelligently supposes that we are likely to have a simultaneous world-wide currency stabilization as a result of a full-dress international conference, the crux of the whole problem resolves itself to arrangements between Great Britain and its principal partners in the sterling area, ourselves, and the gold bloc. After these regions have come to terms, other economically weaker states will later join, either because they have attained equilibrium through their own hard efforts or because they are again granted aid from the stronger financial units.

What are the essential causes of the British hesitancy besides the fact that, so long as the sterling area holds together and Great Britain heads it, they are enjoying relatively stable monetary relations within that particular area, while keeping their hands free against the contingency of violent developments in the gold bloc or here? The reasons are:

First, the Chancellor of the Exchequer declared in 1933 that it was a condition of return to the gold standard that the world level of wholesale commodity prices must recover sufficiently to restore equilibrium between costs and prices, so that an economic return might be had. Since that declaration was made, these prices have risen by very substantial amounts and

* Sir Arthur Salter and Sir Alfred Zimmern were guests at the dinner meeting.—Ed.

more and more adaptation of costs to prices has everywhere occurred. Economic return *is* being had. It is suggested that a further rise in prices and greater economic recovery are retarded by uncertainty about sterling and other currencies, by the unparalleled hoarding of gold, and by the failure to employ available credit, which are the natural consequences of the lack of a sense of security in the world's monetary systems.

Second, the Chancellor stated that exchange restrictions and the prevailing abnormal impediments to the flow of commerce, such as quotas, must be first removed. It is suggested that these barriers, nearly all of which were imposed *after* the onset of currency depreciation, are the natural protective reaction against floating exchanges and that it is hopeless to expect any considerable removal of these obstructions unless the future of exchange rates is tolerably certain. The vicious circle must be broken at some point, and the point at which to break it is where it began. In some instances, such as that of France, for example, the simultaneous abolition of quotas can be demanded as the counterpart of fixing a new parity for sterling.

Third, the Chancellor announced that the gold standard should, in the future, be so administered that wide fluctuations in the purchasing power of gold, attributable to monetary causes, would, to the greatest possible extent, be prevented. I reveal no secret when I say that the Bank for International Settlements has continuously studied the methods of attaining this end and of improving the technique of the operation of an international gold bullion standard, with restriction of the use of gold to the settlement of foreign balances. The Bank has been acting in unison, not only with the Bank of England and other central banks, but with the British Treasury officials, as well; and I believe that it is in agreement with them all that any successful administration of the gold standard requires, among other things, the permanent, uninterrupted coöperation of central banks in the conscious direction and control of the monetary mechanism, acting preferably through a common center. The rules of the game, which were tabulated at Basle, were unanimously agreed upon by the monetary committee of the London Conference, subject to the abstention of the United States delegates.

Fourth, the Chancellor stated that the British external balance of payments must be brought in equilibrium. This, indeed, is vital to all countries seeking stable money. Since the crisis began, every land has been progressing, by devious methods, toward this indispensable equilibrium. Happily, the British balance of payments on current account, according to official publications, is, and for some time has been, in satisfactory equilibrium. Any disturbing movements on capital account appear attributable to the desire to seek a more certain medium of conserving wealth. As important items in the compilation of the balance of payments and the likelihood of its continuing to be balanced, the Chancellor observed that a settlement of reparations and war debts was essential. Reparations *are* settled—the debtor settled them. It seems likely that the debtors will settle the war debts, too; they have made extraordinary progress in the last two years. Let them not disturb that progress by asking for formal approval on our part, unless and until they are prepared to make some moderate offer as a final adjustment.

Fifth, Great Britain must increase its gold reserve. This has been accomplished. The Bank of England—as is also the case of certain other central banks in the sterling area, like those of Finland and Sweden—holds by far more gold today than at any time in its history. The Exchange Equalization Fund holds additional gold supplies and, given stability, quantities of hoarded gold now locked up in London vaults would be surrendered against sterling and some of it find its way to the monetary reserves. Finally, it seems almost certain that, with the advent of currency security, part of the superabundant metal now held in America will flow back to the points of departure whence it fled, because of fright over the possibility of more currency depreciation.

Sixth, Great Britain fears to stabilize because of her uncertainty about the outcome of the American monetary and fiscal policy, which will have inescapable repercussions upon its own credit structure and price system. They consider us light-hearted in our gay experimentations with gold and silver, and light-headed in our program of bigger budget deficits. With so unstable a partner, they question the effective permanence of any arrangement for stability. The answer to this

legitimate reservation must be given by our government through a continuous improvement in its fiscal conduct and by our monetary authorities in a demonstration that they can and will control any inflationary credit expansion. Sound economic policies at home are the prelude to any enduring stability in the world's exchanges. If Great Britain, although officially declaring a preference for the gold standard, and although acutely aware of the indispensability to recovery of an international monetary standard—as is indeed evident from her attempts to widen the sterling area and to make that as international as possible—if Great Britain still wavers, it is chastening for us, before condemning her, to recall that we ourselves are not without sin.

Seventh, general British opinion doubts that the gold bloc can hold until the combined forces of internal deflation and the rise of prices abroad bring this area into equilibrium with the outside world. Until they see more clearly the future of the French franc, they deem it prudent to wait before fixing the sterling exchange rate. As the French franc goes, so goes the whole gold bloc. Can the franc withstand the impact of the unbalanced budgets, repeatedly permitted by the French legislators, with the result that the volume of short-term public debt is now of menacing proportions? The battle is in an acute stage, even as we talk. Paradoxically enough, cruelly enough, because of this British attitude, the date of general stabilization, so long desired by the French, may well be hastened, should the battle be soon lost. The battle is being so valiantly fought that it may well be won. Until it is clearly won or definitely lost no negotiations can successfully be commenced. Thereupon, they should be immediately attempted—not in the glare of an international diplomatic conference, but quietly, between the central banks at the Bank for International Settlements, with the American monetary authorities participating. Whereas it would then be preferable by far to agree forthwith on *de jure* exchange stability, it is likely that this decision will have to be preceded by a *de facto* stabilization program operating for a specified period to observe how the exchanges work; and during that period, a common Exchange Equalization Fund may be desirable.

Furthermore, inasmuch as confidence is the paramount condition precedent to stability, we cannot expect a successful outcome until there is some solution of the principal political problems of Europe, which are the foes of any confidence. If, as I am rash enough to hope, out of the present controversy with Germany, there shall evolve a new set of understandings in which Europe has reasonable faith, then the best groundwork will have been laid.

A series of arduous conditions precedent, you say; — conditions so exacting that stabilization and full economic recovery may be long delayed—but there is more yet. The United States will be called upon to make certain contributions to the restoration of confidence and toward the effective working of the new gold standard. At the very least, we shall be asked the following:

> *First,* to make legal and binding our present system of accepting and releasing gold for international transactions—a system now operated at the discretion of the executive solely, and terminable without notice or cause. There is nothing stable about that.
>
> *Second,* to abandon, in return for fixed parities from Great Britain and the gold bloc, the reserved right to cut the gold content of the dollar a further 16%. There is no stability in that continuing threat.
>
> *Third,* to let gold flow out freely at all times to foreign central banks only, even if the dollar is not at the export point. We have too much gold and should facilitate its redistribution for monetary purposes.
>
> *Fourth,* if it cannot be utterly abandoned by repeal of the legislation, then our silver policy, so disturbing to our neighbors, must be definitely circumscribed—in some such way, for example, as limiting it to the purchase of the output of our own silver mines. Few incidents have so impeded the prospects of stabilization as our silver activities, not merely because of their intrinsic extravagance but because of the irresponsible monetary mentality which they have exposed.
>
> *Fifth,* possibly, to act officially upon a readjustment of the war debts, but I trust that our debtors will have

the wisdom not to over-stress this point, and will realize that there are involved questions of a delicate and extra-economic order which patient time can best eradicate.

Sixth, we shall be expected to pursue a sounder fiscal and budgetary policy, more akin to that of Great Britain than to that of France. We shall be reminded, perhaps, of the sound advice telegraphed to the London Monetary Conference by our president, when he cabled that "reduced cost of Government" was important to ultimate stability, and that permanent stabilization could be properly discussed—"when the world works out concerted policies in the majority of nations to produce balanced budgets and living within their means. . . ."

Seventh, we shall be invited to declare our adherence to the principles for the future working of the gold standard, often called "the rules of the game", which were unanimously accepted at London with the American delegation not voting; or to offer, for general adoption, amendments to those proposals. The aim of these rules, in part, was to consummate a marriage—a union of what was best in the old gold standard, corrected on the basis of experience to date, and of what seems practicable in some of the doctrines of "managed currencies" (many of the aspirations of which are laudable even if their system be theoretical and inapplicable)—so that the resultant technique of the working of the bettered gold standard may be more satisfactory hereafter.

Eighth, we shall be invited to join the Bank for International Settlements, in order to coöperate most efficiently and easily with the other monetary authorities in the joint task of operating and preserving the reformed gold standard, and of continuously studying changing developments, so that the application of the principles of that standard may be modified as experience shall prove desirable. We shall serve our best interests, without curtailment of any of our independence, if our monetary authorities occupy the seats reserved for them on the Board of this non-political

institution, dedicated to the cause of more stable monetary conditions and a sounder credit structure throughout the globe.

The difficult goal of monetary stabilization is not an end in itself. It is but an instrumentality to complete that economic recovery which is on the march. The experiment of floating currencies, whatever its passing justification and temporary advantages, has reached the point of diminishing returns. If we wish to see unemployment reduced, business more prosperous, happiness more general, opportunity more widespread, world trade revived, and nationalism less rampant, then we wish to see the restoration of a stable monetary mechanism, the existence of which was so determining a factor in the expanding prosperity of the nineteenth century.

The world awaits a courageous move that holds out hope of founding this restoration upon ground firmer than the shifting currency values that now prevail. To have assurances that America will not be an obstacle is heartening. To have America demonstrate, by sound monetary and fiscal example, that she comprehends the practical implication of these assurances, would be inspiring.

MR. LEFFINGWELL: I am sure that you will agree that I understated my case in favor of the trained man.

We have had the privilege of listening to a great speech by the man who has been presiding over the deliberations of the Governors of the Central Banks of the World—to the exclusion of the Central Bank of the United States. Perhaps the most important thing that suggests itself from this great speech is, on analysis, how little are the obstacles that stand in the way of agreement between the two great English-speaking nations. Just as sure as human progress is to occur, it will occur by virtue of collaboration between Great Britain and America. As we learn to understand that the love of peace in those two great democracies is the basis of the hope of the world, these technical difficulties are going to disappear before us and we are going to be working together for reconstruction.

The technical subject of money is a meaningless thing if we cannot work together for peace. You cannot have sound money except in peace. You want sound money for trade and for human welfare.

Graduate of Yale and of the Harvard Law School, legal secretary to the late Mr. Justice Oliver Wendell Holmes of the United States Supreme Court, Captain during the war of the American Red Cross overseas, counsel to the Federal Reserve Board in Washington, Deputy Governor, Governor and President of the Federal Reserve Bank of New York, I have the honor to introduce Mr. George Harrison.

SOME ESSENTIALS OF MONETARY STABILITY

GEORGE L. HARRISON
President, Federal Reserve Bank of New York

WE will agree, I think, that monetary stability is not an end in itself. What we desire is to promote and maintain a prosperous level of trade and employment. Our objective is economic stability, and monetary stability is important only as a means to that objective. We all know that money itself is not wealth—we cannot eat it, we cannot wear it, it will not keep us warm. But we know, too, that we live in a money economy, and that a stable mechanism of monetary exchange and a stable measure of value are essential to our economic life.

I am one of those who believe that the world has now reached the stage where international trade—the movement of goods from points of surplus to points of shortage—is an important factor in maintaining economic stability and in producing a higher standard of living, not only for the world in general but for this country, too. It may be true that a nation can live within itself if it must do so, but the price of complete nationalism must be a lower, not a higher, standard of living. In prehistoric times the family unit was the economic unit; the caveman had to content himself with his own ability to hunt for his living; he provided as best he could for himself; his standard of living depended entirely on his own powers to provide for himself. As time went on, as the economic unit grew from the single family to groups of families, or later on, as peoples became organized into geographical or political units, they too, owing to an inadequate mechanism for trade, had to live largely within themselves and to be satisfied with what they could grow or make for themselves.

After centuries of struggle, with the development of transportation and communication to the point where goods and people and opinions can be moved about rapidly and cheaply,

the world has learned to expect and to demand much broader opportunities and a much higher standard of living than was possible when those facilities were lacking. Improved methods of communication and transportation have not only made the opportunities for distribution greater, but the press, the telephone and the radio have stirred the imagination and enlivened the desires of peoples everywhere for the products of other communities and other nations. People are no longer content to accept only that which their own nation affords them any more than people within a nation are satisfied with the produce of their own particular locality. It is true that there have been much discussion and even advocacy of the ideal of a closed economy. I cannot but feel, however, that we are still far from taking seriously such a definition of our ultimate goal—that it is a passing phase, an expression of the world's discouragement with the tangled state of affairs resulting from the war and the depression.

It was as a natural development of the growth of international trade, and of the recognition of the importance of international monetary stability as a means to that end, that the international gold standard was developed. Our problem today is not that international trade is any less essential to the maintenance of a full economic life, but rather that we have been compelled to recognize by the events since 1914 that international monetary stability has become far more difficult to maintain than it was during the last century. The war disrupted and dislocated previously existing economic and monetary arrangements. We have been struggling with the consequences ever since. Probably no monetary system that human ingenuity could devise could have withstood economic changes of such magnitude and rapidity as the world has witnessed since 1914. Just when and how we are to succeed in restoring some definite workable arrangement, is hard to tell.

Primarily, the specific responsibility for international monetary stability rests with governments. The difficulties cannot be dealt with by economists working under laboratory conditions, nor by central bankers alone. Rather, the solution of these difficulties depends on a whole background of world conditions and on the development of a public understanding of the problem which will make it possible for governments to act and

in turn discourage governments from doing those things which will threaten the success of action once it is taken. The solution requires a meeting of many minds.

Anyone who has followed the course of international negotiations since the war must realize how difficult it is to reach agreements even under the most favorable circumstances. We all remember the amount of worry and work, the amount of international discussion, and the amount of patience and good will that went into the effort to reëstablish international monetary stability in the ten years after the close of the war. In the light of that experience, we have no reason to hope for a quick and easy solution of our present problems. The complete cure is not to be found in a single international conference, nor in some flash of governmental wisdom, but in persistent and painstaking efforts over a period of time. Our efforts in the twenties temporarily achieved their objectives but failed of a permanent solution. The question today is whether we can do a better job than we did in the twenties. We start with a handicap of failure behind us which in certain ways makes our task more difficult. On the other hand, we should have learned something from our experiences.

No meeting of minds on international stability can be expected or desired without a favorable combination of circumstances that will give a reasonable assurance that any formal agreement which might be reached will have a fair prospect of being sustained. At the moment, with a large part of the world harassed by grave political uncertainties and many important governments, whose budgets are already badly out of balance, spending more and more borrowed money for necessary relief, and for what I hope are unnecessary military establishments, it is hard just now to foresee any very early combination of circumstances that will permit of definite world currency stabilization by international agreement. We can only hope that there may soon develop a quieter and more coöperative atmosphere.

Already there is a favorable side to the picture. The progress of world recovery since the middle of 1932 is now creating underlying economic conditions which make international monetary stability more feasible. During the depression the fall of world prices, the general contraction of

production, and the decline of national incomes, greatly accentuated the many elements of unbalance resulting from the Great War. Each nation felt forced to resort to policies designed to protect its internal economy. The result has been a tangled network of defensive measures such as the depreciation of currencies, the arbitrary control of foreign exchanges, and the restriction of trade through embargoes, quotas, clearing agreements, licenses and tariffs.

All these defensive measures, while different in form, were essentially of the same origin, purpose and effect. Whether they were necessary or unnecessary, the general result was a progressive strangulation of international trade, which in turn reacted seriously, in many cases, upon domestic trade and employment. At the lowest point, the total value of world trade was only one-third that of 1929, and the physical volume of trade had fallen by 25%, the largest decline in history.

On broad economic grounds one might now expect a reversal of this process. For, just as nations during the depression cut themselves off from external deflationary influences, they ought in recovery to seek, by a removal of barriers, to share in the beneficial effects of a general trade revival. In other words, nature is now on the side of the doctors.

It is a mistake, however, to suppose that the problem will eventually solve itself, even when political conditions become quieter. There is much that can and should be done to pave the way for effective international stability when governments determine, in the light of both the political and the economic situation, that the time is ripe to act.

One of the first things we may well do is to think through and try to dissipate the philosophy of defeatism which has been growing up with respect to the possibility of operating an international monetary standard, even in modernized form. We must, I think, fairly recognize that there is now a considerable school of thought which is frankly skeptical about the desirability of a return to the gold standard or to any international standard. Their doubt arises in part from the general drift towards national economic autonomy. It is more largely derived, however, from theoretical considerations as to the relation between domestic and international stability, and these

considerations have led many to believe that there is a fatal antagonism between the two.

I think that this belief has grown out of the pre-war theory of the gold standard and our experiences of the past twenty years. The pre-war theory of an "automatic" gold standard carried the implication, in its abstract logic, at least, that economic disturbance, wherever originating or whatever its nature, could be dissipated and corrected by the flow of gold. There was a sound core of truth in this view, but it also contained the dangerous suggestion that all a country had to do was to adopt the international standard and fold its hands in the confident expectation that that beneficent system woud protect it from all economic ills.

That there were shortcomings in the gold standard, as we have known it in the past, no one now questions. But it was not the gold standard *per se* that failed us after the war. World recovery was never soundly reëstablished. The reparations question, despite all that was done to effect a settlement, refused to be settled. War debts remained a source of disturbance. The economic position of a number of the countries of Central Europe was never really adjusted. The rates of stabilization of some countries, such as England, for instance, were such as to require a greater economic readjustment in those countries than could easily be achieved with existing inflexibilities in those countries. America's new position in the world's economy favored a flow of gold to this country which weakened the position of a number of other countries and formed a basis for excessive speculation here. These and other economic causes for instability were back of the later financial disasters. They were responsible in a large measure for the tremendous volume of short-term funds washing about the money markets of the world in defiance of all the ordinary rules except the rule of fear.

It was against this background that the events of the years from 1931 to 1933 succeeded in generating an overpowering psychology of fear which became in itself a disturbing element apart from its original causes. Fear, following the failure of the Credit-Anstalt in Vienna early in 1931, precipitated a crisis in Germany. Fear then crossed the Channel to England and forced the suspension of gold payments there. Fear of disaster

here began to draw gold from the United States in vast quantities. As the focus of fear turned upon this country it found to feed upon a banking situation built up very rapidly during the past three decades, when weak unit banks were allowed to spring up like mushrooms all over the country. We know the results. When such fear takes hold of the imagination of the people nothing will stop it until the structure itself collapses.

No one who went through the banking crisis of February and March 1933 will ever forget the irresistible rush of panic through the country. On February 14 the Governor of Michigan declared a state bank holiday, and then in rapid succession one state after another in different parts of the country took similar action until on Saturday, March 4, practically every state in the Union had closed its banks. In the period of about three weeks from February 9 to March 3 the people of America, in fear, had withdrawn approximately $1,700,000,000 in money from their banks, an amount which equaled about 35% of the total money in circulation in the country, even in the boom days of 1929.

We shall never forget the first three days of March in the Federal Reserve Bank of New York. On Wednesday, March 1, in that bank alone, we paid out $51,000,000 of currency to our member banks; on March 2 it was $80,000,000; on March 3 it was $176,000,000. On that last day, March 3, we also lost $87,000,000 through transfers of funds to other districts, and $78,000,000 through gold exports and earmarkings. In addition the public crowded into our bank corridors to withdraw gold. In those three days, they carried off in bags, in suitcases and in their pockets over $100,000,000 in gold coin and certificates. The movement was cumulative. Each day was worse than the preceding one. This was a fear which would wreck any sort of banking system. It was this situation which President Roosevelt must have had in mind when he said in his radio address to the nation at the end of the bank holiday in March: "All we have to fear is fear itself."

I do not suggest that the collapse of the gold standard in the early years of this decade was entirely due to international maladjustments or to the psychology of fear which spread through the world. We must also recognize the effects of an increased rigidity of the internal economic mechanism of many

countries which had been developing over a long period of time. The impact of external forces, operating through gold flows, upon the internal economy of these countries had become much more painful than was formerly the case. It is not too much to say that this increasing inflexibility has become the central economic problem of our generation, the root difficulty, whether one is considering the feasibility of international monetary stabilization or the problem of how to achieve and maintain economic stability at home. Given a rigid internal price structure, rigid costs of management and labor, there is danger that the international gold standard may have exactly the opposite effects from those which the gold standard theory contemplated. Instead of correcting economic disturbance, instead of encouraging stable prices, the gold standard may then become the channel of communication through which disturbances are transmitted around the world, bearing the germs of disease rather than the serums of prevention and cure.

I think this becomes clearer if we bear in mind the fundamental distinction between rigid and stable prices. A rigid price structure is a static thing in a dynamic world. It resists adjustment, and so intensifies maladjustment. Stable prices, on the other hand, are dynamic. The ship and the airplane offer no blind resistance to the winds and currents, but move steadily through them by a process of constant adjustment. They move, they have a destination, and they carry passengers and freight.

Now, the increasing rigidity which we have witnessed has been cited by some as proof that an international monetary standard is no longer workable. That seems to me the shallow and shortsighted conclusion. It ignores the great dangers and hazards of fluctuating exchanges as well as the competition in defensive measures to which they lead. Financial armaments, like military armaments, are expensive and unsatisfactory. Moreover, there is implied in this whole view the fallacious notion that nothing more is involved than a mere act of choice—that we are entirely free to choose between domestic monetary stability and international monetary stability. It would be nearer the truth, in my judgment, to say that neither is possible without the other. Unless each country is literally to build a wall around itself, our economic problem will always

be one of interplay between internal and external forces, and no amount of choosing between fixed or flexible exchanges will get around that fact.

We are apt to think of the world as an abstraction, as something apart from the countries that make it up. If we get beyond this, we are apt to think of it as consisting of some sixty countries, all mutually and more or less equally interacting upon each other. It is perhaps nearer to reality to think of the world as consisting of a few pivotal countries and their economic spheres. What happens to the world depends primarily upon what happens to these pivotal countries. From this point of view is it not reasonable to conclude that the money question is mainly one of the impact of internal monetary conditions in these few countries upon the remainder of the world? If these countries could preserve monetary stability at home, coupled perhaps with some safeguards against excesses of international capital movements, then fixed exchanges and gold flow would provide a means of imparting to the rest of the world the stabilizing influences developed and maintained in the pivotal countries.

This approach focuses attention on the problem of internal control in the leading commercial countries. On it would depend the achievement of both internal and external monetary stability. There is, after all, nothing very novel in this view. Stated in homely terms, it simply means that we who make up this group can do much to keep the world in order if we can keep our own houses in order.

We in this country have already made some progress in this direction. The dollar has been stabilized in terms of gold since February 1, 1934. We have maintained that stability in relation to other gold currencies by the free purchase or sale of gold at fixed prices. Furthermore, responsible officials of our government have indicated, in effect, that we are ready to consider international currency stabilization when other countries are ready to do so.

We have enacted legislation designed to avoid a recurrence of some conditions which contributed to our own and to world difficulties. That is particularly true with reference to the speculative apparatus which in the late twenties drew funds to this market from all over the world, funds which we did not want and funds which the rest of the world sorely needed.

In certain particulars we have amended and, I believe, strengthened our central banking mechanism by giving the Federal Reserve System additional powers of credit control, such as the powers to fix margin requirements and to change reserve requirements. The exercise of these powers will call for wise judgment and courage. It must be admitted, however, that even though the powers of the Reserve System for dealing with credit problems have been increased, they are not complete in themselves partly because other governmental agencies also have vastly increased powers. The System, therefore, cannot of itself assume final or full responsibility, at least not until some of the emergency laws dealing with monetary and credit matters have expired or have been modified or repealed. These emergency laws not only divide responsibility; conceived in depression, they risk being real sources of danger in recovery.

So, also, our commercial banking system which collapsed under the strain of 1931, 1932 and 1933, has been safeguarded in various respects. After the banking holiday of 1933, only those banks believed to be sound were permitted to reopen, so that many weak banks were eliminated from the banking structure. Furthermore, a large number of banks have since joined the Federal Reserve System and are now under some form of national supervision through the Federal Reserve System or the Federal Deposit Insurance Corporation. The capital structure of under-capitalized banks has been restored through private subscriptions and through the Reconstruction Finance Corporation.

In spite of these steps, however, there are still some fundamental shortcomings in our banking system which, to my mind, must some day be corrected if we want to avoid future weakness.

Our commercial banking system grew up much like Topsy. At the beginning of the depression it consisted of about 24,000 separate unit banks all organized and operating under 49 different sets of laws—the federal law and the laws of the 48 states. Some of these banks were members of the Federal Reserve System but two thirds of them were not. The Federal Reserve System was superimposed upon this heterogeneous group of banking institutions without any substantial change in the basic system itself. No central banking system can be made

a substitute for a sound commercial banking system. So, while many steps have already been taken, we shall not be able to boast of a wholly adequate banking structure until such time as it may be possible to develop a more unified commercial banking system with greater concentration of both authority and responsibility.

This implies a greater uniformity of banking laws between the different states, on the one hand, and between the states and the federal government, on the other. It implies greater consistency and effectiveness of banking supervision, responsibility for which is now divided among too many agencies. It implies the necessity of improving the general character of bank management through the development of some more liberal system of branch banking within appropriate areas. It implies some satisfactory disposition of the knotty problem of separating the commercial banking function from the savings banking function. The combination of these two functions in the same institution has been one of the apparent causes of our banking troubles of the past. Lastly, it implies the ultimate necessity of bringing all the commercial banks of the country into the Federal Reserve System.

The precise answer to these questions is difficult to determine either as to time or method. It will require thoroughgoing and thoughtful study, and perhaps a gradual solution; but we should not rest content until the problem has been recognized and its solution undertaken. I do not mean to imply that our banking system today endangers the economic stability of the country or the funds of its depositors. But I do mean, that it will never function to the full limit of its usefulness and safety until these questions are considered and disposed of in some satisfactory fashion.

In this brief summary of some of the things which we have done in this country and still need to do in setting our house in order, I have referred altogether to the financial aspects. To avoid misunderstanding, let me add this general qualification: that the financial soundness of a country is not something independent from the soundness of its whole economy. It is not possible to have sound finance unless there is also a sound industrial policy, a sound labor policy, a sound basis for the distribution of the national income, and a sound governmental

fiscal policy. To a considerable extent the financial well-being of a country is but the reflection of its whole economic life. So I have been discussing not the whole of the problem but rather that part of it which comes more within the direct sphere of the responsibilities of a bank of issue. One of the results of our complex existence is that responsibilities can never be wholly segregated and fixed. No question of great importance in terms of human welfare can be narrowed down and dealt with in a single sphere. Each question is dependent somewhat on the other.

It is obvious, therefore, that domestic problems will not solve themselves any more than will international problems. We should not be content to sit back and wait complacently for the solution. Each nation, while working for a removal of the international barriers to stability, might profitably direct its course towards domestic stability.

As I say, we in this country have made some progress; but we have more to do. The same thing is true of others. Many nations have unbalanced economies, drastic trade and exchange restrictions, problems of relief and unemployment, or budgetary difficulties, quite apart from political uncertainties. The solution of some of these problems and the removal of at least some of the existing obstacles to international trade, might well be undertaken promptly in order to facilitate world monetary stabilization. If these things are not done, if governments persist in stifling international trade for uneconomic reasons, and if nations or whole groups of people, over too long a period, are denied the right of a decent standard of living because of man-made barriers to the exchange of their goods and services, then, in the light of past history, they will seek that right, sometimes ruthlessly and by force, just as men have done from the beginning. If, on the other hand, nations now persistently and vigorously apply themselves to a solution of these questions, then when the time does come for international monetary action, whether it be between large groups of nations or simply between the nations whose currencies are the principal media of international trade, we can look upon whatever action is wisely taken with a fair degree of confidence that it will survive and contribute to the prosperity and happiness of peoples everywhere and, not least, to our own people.

Remarks by the Chairman

Mr. Leffingwell: I know that I speak for you all in parting, when I thank Mr. Fraser and Mr. Harrison and the Directors of the Academy of Political Science for the privilege of listening to two great speeches, spoken with the high authority of men who have devoted their lives to distinguished public service.

THE PROSPECT OF INFLATION IN THE UNITED STATES *

JAMES HARVEY ROGERS
Professor of Political Economy, Yale University

IN the twenty minutes allotted me I shall attempt to discuss the prospect of inflation, and virtually nothing else. In particular I shall not discuss the *effect* of inflation. But in view of remarks of the second speaker this morning,[1] perhaps I should begin with a definition of inflation. I can assure you that I shall not mean anything mysterious.

I have contended from the beginning that recovery and the early stages of inflation could not be told apart by anyone. They are identical in every respect. Whether we now have inflation, or whether we have recovery, or whether we have just credit expansion, is a matter of definition and nothing else. We have, of course, credit expansion, and we have a certain degree of recovery, as is well understood by most people. If I should define inflation (that is, what I shall mean this morning when I am talking about the prospect of inflation), I should say very simply that it is a considerable further rise in prices, accompanied by a further rise in bank credit expansion; and if you wish me to define " considerable ", I should say perhaps something like double, that is, a doubling of the present price level. I should certainly call that inflation.

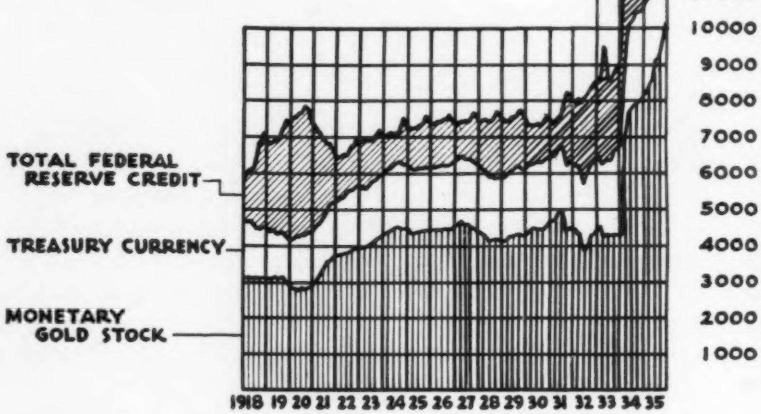
I shall begin by reviewing very briefly the things which may be pointed out as possibly leading to inflation in this country, and then I shall proceed to describe these as accurately as I can. The first is our huge gold reserve. Some people regard that as an inflationary influence. Second, the huge excess reserves of our member banks, which are higher today than at

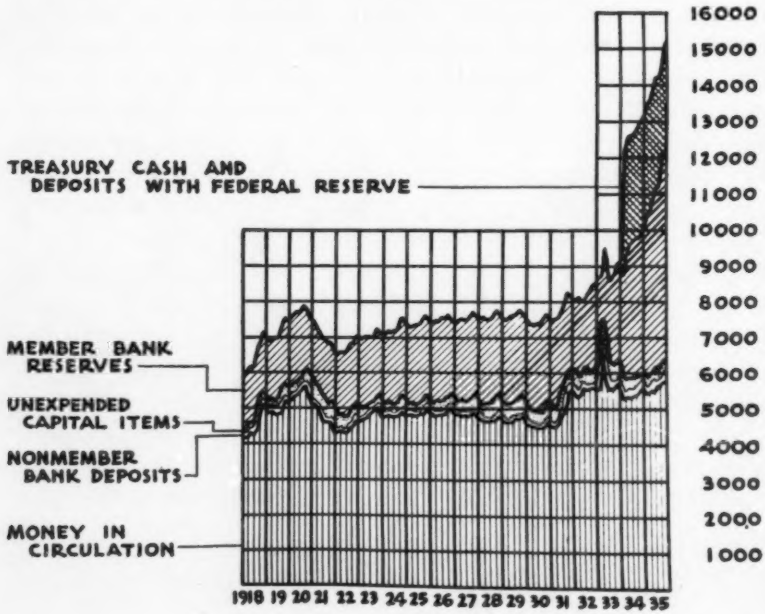
* Under the title " Prospects for Inflation " this paper has been published by the University of Minnesota Press; it is reprinted here by permission of the publisher, and with minor changes due to the occasion.—Ed.

[1] Mr. Ralph Robey, *cf. supra*, pp. 10-16.—Ed.

MONETARY BASE OF THE UNITED STATES AND ITS UTILIZATION

(IN MILLIONS OF DOLLARS)





any other time in our history. Third, a temporary inflation trend. Fourth, a highly undervaluated dollar. Fifth, a national budget deficit—and a big one. I shall discuss these in turn as they seem to appear logically in the argument.

What is the threat of inflation?

First I shall take it up from the money side, and I take it up especially in this form because it happened that the evening after we had gone off the gold standard, or rather after the American public had discovered that we had gone off the gold standard, I was speaking on the subject of inflation in New York City, and on the same platform with the last speaker.[2]

Some people thought when we had gone off gold we were going to get a terrific rise in our *general* price level almost immediately, in fact within the next few days, or the next months at the latest, and from the money side purely. Having been in a way connected with what happened in our money system, that is, with the money manipulation, if you please, I think it fitting to begin with that side, by showing you its inflationary effects and the controls that have been built up. At every step precautions were taken to build up controls.

I call your attention to the chart, and as it represents a balance sheet of our money system, I invite your careful attention at this moment.

You will notice that we have a top chart and a lower chart, and the ordinates for every single month are the same in the top as in the bottom. I call it "Our Monetary Base and Its Utilization". In this upper chart I have the total monetary funds that are available for our use: and I show exactly how we use them in the bottom chart.

Let us look at this balance sheet. We have three major sources of our monetary supply. The first is the gold stock, which comes either out of the mines or else from abroad, and goes directly into our money system: that is represented by the gold portion on the chart, and it represents of course the major portion of our total monetary base. Then we have two *organizations* in our financial structure that are issuing currency. One is the United States Treasury, the other is the Federal Reserve Banks. The Treasury currency is the un-barred portion of the upper chart. The Federal Reserve credit that is

[2] Mr. Robey.

outstanding for each month is the obliquely-barred portion. Each quantity is built on top of the one below, so that total ordinates give us the total money supply. However, part of it is not money at all, but Federal Reserve credit, so I speak of the *monetary base* instead of total money, Federal Reserve credit being identical with the others for this purpose.

The utilization chart is at the bottom. Strangely enough, even though only a little over one tenth of our business is done with money, a great portion of our credit base is used for money in circulation, as indicated by the vertically barred section. Then there are the two minor items, the dotted portion representing capital, surplus and undivided profits of Federal Reserve Banks and the unshaded item representing non-member-bank deposits. Then come member bank deposits, which take up the next largest portion of the total monetary base and finally we have the checked section which represents the stabilization fund and the deposits that the Treasury has with the Federal Reserve Banks. That is what has been impounded of our total monetary base; in fact the stabilization fund was created in such a way as to impound a part of the monetary base so that it would not go into member bank reserves, as it otherwise would have done, and thus tend to make these member banks' reserves correspondingly more difficult to control.

This is the monetary set-up, and remember, the ordinates in the lower chart are exactly balanced with those in the upper, to millions of dollars, which is a very close balance indeed for a set-up of this sort.

But what about the inflation threat?

Of course, in the first instance, any expansion of our total bank credit comes in the member banks, and on the basis represented in the chart by the member banks' reserve account. The excess reserves of these banks are at their all-time maximum of about three billion dollars, furnishing a possibility of very great expansion. That we would call *primary* expansion, or *primary* inflation, which expansion can take place at any time unless certain controls are used to stop it.

How great the expansion of deposits on these reserves could be would depend on how much money would flow into circulation in the course of the expansion, and also on how much gold would flow abroad in the course of the expansion. To the

extent that gold flows abroad, it lessens the whole of the credit base. To the extent that it flows into circulation, it will be absorbed, and will reduce the base on which expansion could occur. I should say a four- or five-fold expansion—twelve to fifteen billions of deposits — on the existing excess reserves would not be great. We might even get a ten-fold expansion —thirty billions of deposits.

Furthermore, let me call attention to one possible form of increase in the monetary base itself, one which is continuously before us, since Congress is continually bringing it up. Suppose that the stabilization fund were abolished, simply taken over into the revenues of the Treasury. Two billions would be added to the excess reserves by simply utilizing this vast sum instead of keeping it impounded in the stabilization fund. Its expenditure would throw the two billion dollars into the excess reserves, and thus increase the basis upon which any direct expansion might occur.

Now, however, I turn again to the unshaded item above, the Treasury currency. To the extent that the Treasury is printing silver certificates, that item is increased, so that a like increase appears in the total of our credit base, and simultaneously in member bank reserves, for the simple reason that the other "utilization" items, being dominated by different influences, will not take it. So, to the extent that we are increasing our silver certificates (which is small at present and not dangerous) we likewise increase the member bank reserves, and in that way make possible a still greater expansion.

So much for the *primary* expansion possibilities, *with the monetary set-up as it is at present*. Let us look now at the *secondary* expansion possibilities.

I spoke of the great increase in our gold reserve, which came out of devaluation. Early in 1934, we devaluated the dollar. Notice (on the chart) the increase in the gold supply (value) that came with that monetary action. An increase of 69 per cent came on account of devaluation itself. Since that time the gold imports and the increased production of new gold have led to a still higher total, so that we have now a little more than ten billions in our monetary reserve. This is not dangerous, for the simple reason that I think we can assume that our Federal Reserve authorities can control it, and will not

expand unduly except for other influences which I shall discuss later; hence the possibility of a secondary expansion coming out of the early utilization of that gold supply seems not very great.

I call attention again, however, to the fact that the existence of that gold supply puts us in much the same position as after the great gold discoveries of the Klondike, of California, or of the Transvaal, or even as after the discovery of the Americas flooded the world's money systems with new gold and silver. But for the present, it is impounded sufficiently and is not an immediate threat.

We have all learned, however, and I think we have learned for a long time to come in this country, that expansion possibilities are very different from expansion actualities. The fact is that when we built up our excess reserves, I, for one, thought they would be used somewhat more rapidly than they have been used; and many thought they would gradually be utilized because of the very plentiful money and low rates to which they gave rise; but we have discovered that the full potential rise has not even yet become actual.

Hence, still another side of the picture. What are the stimuli to further bank credit expansion?

Of course, you immediately expect me to turn (and I do turn) to the subject of budget deficits. Our budget deficits, as you know, have been financed only partially by selling bonds to the public, and in considerable part by selling short-term government paper to the banks; and thereby we have gotten a bank credit expansion to the extent that the banks have bought government securities.

One might raise the question as to why such financing is inflationary. As a matter of fact, it is inflation of the purest kind. We have increased the expansion of bank credit, increased the purchasing power of some one (in this case the American government) without taking away any funds from anyone else who was going to spend them for other purposes. It is pure expansion of bank credit, with the resulting increased purchasing power being turned over to the federal government —just the type of inflation that was needed before recovery started.

I was talking to a group in London in 1933, and a good many people interested in this subject were present. One of the

Board of Governors of the Bank of England expressed the wish that the British government would greatly *unbalance* its budget —if necessary, by returning all of the taxes. He had spoken to certain government officials, he said, and advocated it. Such action at that time would have been extremely intelligent in that it would have provided the sort of inflationary influence that was needed to make the machine start again; but I was tremendously surprised that one of the Board of Governors of the Bank of England should dare suggest it.

Our budget deficit has provided much of the expansion we have had to date; and it begins to look as though it might provide much too much, now that we have passed the turn, and now that the budget is again upset.

But, as to the other possible stimuli.

Some people said when the dollar was made as low as it was, foreign buying would set in. Today the greatest bargains one finds in the world are in America. Foreigners would find enormous bargains here. But that has not proved much of a stimulus because they cannot get over here with their money. There are all sorts of restrictions; tariff barriers, quota systems, and exchange restrictions of one sort and another, all prevent them from getting into our markets. In the immediate future I do not expect much more stimulus from that source than we have gotten to date, so we can leave that influence out temporarily.

We are getting, however, a degree of domestic recovery. Business is recovering. Business borrowers are coming back into the investment market; they are selling their securities. Even the short-time loan market shows prospects of recovery. So, added to the stimulus from budget deficits and resulting inflationary finance, we are getting another stimulus which is coming from business itself.

What about the controls?

I said a few minutes ago that when our monetary system was revised, controls were built up with very great care indeed. The " stabilization fund " was created to keep extra new funds (the gold profit) from going into excess reserves. It is of the utmost importance that Congress should not take that fund and spend it. If we can hold the " stabilization fund ", we have

checked, to a considerable extent, the threat of inflation coming from the great gold profit which appeared when we devalued the dollar.

One of the normal means of reducing bank reserves would be to sell the "earning assets" of the Federal Reserve Banks. These are not great enough, however, to eliminate the excess reserves even if all of them could be sold. There are certain portions of the reserves that could be disposed of, but in the disposition of them, great difficulties are likely to be found, because the part that is easy to dispose of is made up of government securities, and the government is not going to welcome such competition from the Federal Reserve Banks. Therefore, it may be extremely difficult to use that particular device. Control through the discount rate is pretty limited; rates are so low and money so plentiful that the discount rate is of no use at present.

What is left?

One other control, the one which was put into the last bank act, is the power of the Board of Governors of the Federal Reserve System to raise the requirements of the member banks by a maximum of 100 per cent. I am sure the bankers present will not like the idea of having their reserve requirements raised, but it may be necessary; and to raise the reserve requirements of member banks by doubling the present reserves will give sufficient control to reduce the excess reserves to a place where they are no longer dangerous. My contention is that it *may* be necessary to raise greatly the reserve requirements, and, if it is necessary, they *should* be raised.

Now, I come to something else. What about utilizing the control forces? These are very great, and here hangs the whole problem.

With the big budget deficit, and with no prospect of its becoming much smaller immediately, Treasury financing will be very large. Treasury financing means selling government securities of some sort. I think it means increasing the sale of short-term government securities, because the buyers, as recently, will have to be the banks, to a very considerable extent. Moreover, every single control device, by its very nature, has to be a device which will reduce the member bank reserves upon which the whole credit expansion rests. To the

extent that these are reduced, the capacities of the banks to buy government securities will also be reduced, no matter what device is used.

Unless we can get our budget into control, the Treasury will have to finance, and if the Treasury has to continue long to finance on a large scale, its policy will conflict with that of the Board of Governors of our Federal Reserve Banks when the latter try to tighten money and pull in bank reserves—and I, for one, do assume that the new Board of Governors has backbone enough to apply the controls and will understand the necessity of reducing bank reserves in this way. However, I see an inevitable conflict between the policy of the Board of Governors of the Federal Reserve System and the necessary financing of the United States Treasury *unless we can get the national budget under control.*

I make a very definite answer, therefore, to the prospect of inflation. It is directly dependent upon the control of the national budget. If a balance within the next few years can be definitely provided for and clearly foreseen, the spectre of uncontrolled inflation can be dismissed. If, on the other hand, future approaches to a well-ordered and gradually balancing budget such as the one recently proposed to Congress are to receive the disrupting treatment given that one, the prospect of inflation is very grave indeed.

It was budget difficulties that produced all the post-war inflations in Europe. If we have inflation, it will be because our budget gets out of control. I think, therefore, the problem of the prospect of inflation can be reduced to those terms.